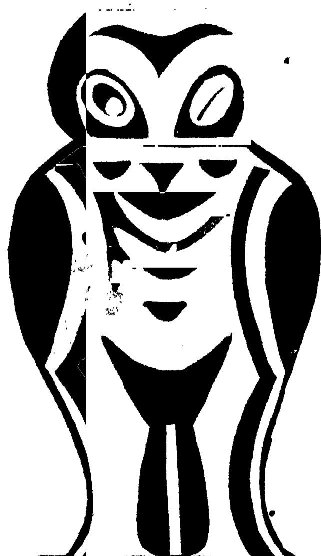
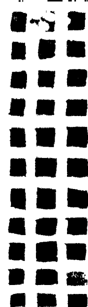






# THE ESSENTIALS OF FEDERAL FINANCE

*BY THE SAME AUTHOR*

THE FISCAL SYSTEM OF INDIA

SOME ASPECTS OF FISCAL RECONSTRUCTION IN INDIA

# THE ESSENTIALS OF FEDERAL FINANCE

A contribution to the problem of financial re-adjustment in India

BY

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# PREFACE

It is not necessary to offer any explanation for writing a book on the problem of *financial* re-adjustment at this hour. The importance of the problem is self-evident; and it is also obvious that the smooth working and the harmonious development of the new constitution will to no small extent depend upon the nature of its *financial* counterpart. The problem of national reconstruction has many aspects, and has to be approached with a due appreciation of the concrete facts of the present situation. But it has also to be realized that it can be solved only if a conscious attempt is made to express and develop a unity of purpose through all our national institutions. It will not do to attempt things piecemeal or deal with each problem of national life without taking into account the significance and bearing of the integral whole. For reconstruction we need vision and practical craftsmanship. Both are equally necessary; and one without the other will lead to a fragmentary, and therefore ineffectual, action.

Two points are intended to be emphasized in this book. First that we must pay due regard to the future and its needs. The latter is a living factor in the affairs of men, and anyone with an adequate understanding of the trend of things cannot fail to feel its impact at a thousand and one points in our daily life. Finance is a part of life, and a study of the working of the financial institutions of the different countries cannot but bring home to our minds the fact that a new world is in the making, and has to be reckoned in all our constructive efforts. The fact is borne

in upon us if we make an earnest effort to understand the nature and meaning of the changes that are in progress in every sphere of life. But even in the domain of finance it is clear that there is what one author calls luminous confusion—a lack of order and symmetry, because the old is giving place to the new and the process of substitution has just begun. In India as elsewhere we have to make allowance for the fact and anticipate the future.

The second point, which is also of fundamental importance, is that we must show our understanding of the purpose implicit in things by handling the various outstanding issues in an adequate manner The future is not going to burst upon us with a thunderclap and assert its ascendency. It will become increasingly effective by informing the ideas and institutions of men with a new purpose. We must take things as they are and modify and transform them with a view to speed up our progress. This can be done only if we face facts and realize the limitations under which we have to work. We must set to our task in the spirit of an artist. Our limitations must be regarded as our opportunities, and we would use them as our material out of which a new pattern has to be woven and a new model hewn. The future and the past seem to be in conflict with each other, but the latter will give place to the former if it is properly understood and its exit facilitated by the adoption of adequate and effective measures, we must, in other words, liquidate the past.

These two points have been emphasized in this book in order to make a practical contribution to the problem of impending financial re-adjustment in India. The book is not a utopia in any sense of the word. It is concerned with the next step in our financial evolution, and its

arguments are based on the assumption that India will be self-governing in a very large measure in the immediate future. At a time when the air is rent with war cries and the prospect of working out a solution of our political problem on the basis of mutual understanding is remoter than ever, it is not easy to get men to listen to the voice of reason and do strenuous thinking. But we have to take ourselves seriously and address ourselves to the problem of reconstruction in the hope that the freedom for which we are longing will soon be ours. It may be that those who have lost faith in the methods of persuasion and are resorting to direct action are in the right; but even then the work of reconstruction has to be seriously taken in hand. The problem of financial readjustment has to be solved in any case, and it is hoped that earnest students of our national problems will think out the various issues involved in the consideration of our financial problem, and find in this book material and arguments which will help them to come to the right conclusion with regard to them.

I must express my gratitude to friends who have helped me in various ways. To Mr. E. A. Horne, M. A., I.E.S., late Principal, Patna College and now Pro-Vice-Chancellor, Aligarh Muslim University, I owe more than I can tell. The patience with which he has corrected the proofs and the pains which he has taken over the whole book, and that at a time when his hands were otherwise so full, make it necessary for me to convey to him my sense of indebtedness for all that he has done for me. I needed just the kind of help that he has given me, and I cannot be too grateful to him for it. I also owe my sincere thanks to Dr. S. K. Maitra, M.A., Ph. D., Professor of Philosophy, Benares Hindu University, for having translated Dr. Albert Hensel's *Der Finanzsa-*

*usgleich in Bundes Statten* for me from German into English. I am also greatly indebted to Professor E. R. A. Seligman of Columbia University for his having replied to my queries with the utmost promptitude and cordiality. I ought to add that I alone am responsible for the views expressed in this book.

GYAN CHAND

*24th April 1930*

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# CHAPTER I

## *The Problem*

India is to have a new constitution. The prospect of framing one which will meet with general approval is rather remote at present. The general attention is just now engrossed by events, which, whatever their importance under the exigencies of the present political situation, cannot be of much account in determining the ultimate destiny of our people. The world is full of portents and presages; and sensitive spirits are everywhere feeling the vivifying touch of the future on the ideas and institutions of the people. A new world seems to be in the making; and though this cannot be ushered in all at once, or without some painful readjustments, it is already a factor to be reckoned with in the affairs of men. India's political freedom is an essential constituent of the new order, and has to be conceived as a part of the world-process. It cannot come to us as a gift of the gods. No nation deserves to be free without strenuous exertion or great sacrifices. But one important condition of success under the overwhelming difficulties of the times is that we should have a right sense of values. We must learn to distinguish between essentials and non-essentials, and assess the relative importance of measures and policies in the light of our vision of things to be. It is wrong to let the past come into conflict with the present or pay undue attention to survivals which have no future. The past may live in the future, but it is the latter which must provide the pattern for schemes of reconstruction. The leaders of national life have to cultivate, in some measure, the qualities of seers, and look ahead for inspiration. It is necessary for right thinking and action that our gaze should be fixed on the India of our hopes and aspirations; and the proposals for the solution of our national problems bear the impress of coming events.

India is a world problem. She is the cornerstone in the edifice of British Imperialism, and her freedom will not only be a boon to herself but also to the British Empire and the world at large. The British Empire will become a real commonwealth of nations and cease to be a menace to the peace and harmony of the world, which it undoubtedly is at present, if India comes to her own as a self-governing member of this confederation. India's freedom will also be an effective answer to what is called the challenge of Asia, and stem the rising tide of colour. This cloud on the international horizon need not grow bigger if India becomes a signpost on the path to new freedom instead of an achievement of forces which do not make for righteousness. But there is another and more important sense in which India is really a world problem.

India is a land of contrasts and contradictions. The differences, which are the hope of the enemies of our freedom and the despair of its friends, are great, and give rise to problems which are as baffling as they are urgent. The diversity of races, religions, languages, cultures and interests is the most striking fact of our national life. It was Sir John Strachey who wrote that the first and most essential thing that could be learnt about India was that there was no such country. The argument has, since then, had its edge blunted on account of the frequency with which it has been used against our national claims. But the differences do exist, and have to be taken into account by the architects of our future. India is, to use Walt Whitman's words, 'immense and contains multitudes'. This fact makes it necessary that in our nation-building we should work for a synthesis which makes this diversity an organic part of our common life. The task is difficult, and needs a combination of courage and caution, vivid imagination and practical good sense, and qualities of craftsmanship of the highest order. But this is our work in the scheme of things, and there are elements in our heritage, which qualify us for its accomplishment if we know how to use that heritage to the best advantage. It is obvious that the unity of our national life must be multiple in its essential character, and provide for the full expression of the

diverse elements which go to make what has to be the Indian nation of the future. This elementary but cardinal fact suggests a consideration of vital importance, and one that ought to take precedence of all others in our constitution-making experiments. Its immediate bearing on our political future is, of course, obvious. It is making it exceedingly difficult for us to present a united front to the hostile forces, and makes it possible for them to count upon the support of some sections of our population for the continuance of the foreign domination of our country. It is a very unpleasant fact of the present situation, one which makes it necessary for us to consolidate our position in every possible manner. Some of us have, as a matter of fact, begun to speak of the past as a great incubus, and feel poignantly the truth of the dictum 'Happy is the nation that has no past'. As such thoughts and feelings cannot change the realities of the situation, it is of greater importance to look for those factors in the working of our corporate life which can be utilized to erect the superstructure of our national life on sound foundations. Some of the most competent students of our history are of opinion that we have, through the ages, shown our genius for constructive synthesis in a manner which has no parallel anywhere in this world. If the people of India to-day present, to use the words of Lord Ronaldshay, 'an ethnologic pageant epitomizing the gradual growth of civilization through centuries of time', it is not because it was impossible to realize unity when there was so much diversity, but probably because diversity was considered essential for evolving unity of a higher order. Indian history is, if we read it aright, an experiment in nation-making without stamping out differences. The process is essentially different from the one which has been so often tried by the western nations in recent years and with such grievous consequences. The experiment seems to have failed; and the view that national unity in India is a phenomenon of recent growth, and has to attain a higher stage of maturity before it can be made the basis of a new political fabric appears *prima facie* specious, if not convincing.

But if we leave out the last four or five centuries, and take a bird's eye view of Indian history from the earliest times to the sixteenth century, we shall be able to appreciate the greatness of the achievement, which our people have to their credit, in assimilating so many different communities, races and cultures into one organic whole without resorting to the use of what are now called Imperialistic methods. The Indian view of life which postulates the necessity of difference for all vital and life-giving processes of growth made it possible for India to become a melting pot of races and cultures without imposing a uniform standard of thought and action on the different streams of immigrants who made this country their home. The idea that any culture, system of beliefs, or code of morals is inherently superior to all others, and has a right to replace them is alien to the ethos of our people, and has never been made a regulative principle of our national life. This great social and eugenic experiment has given us these numerous divisions of our society, and is now a travesty of what it was intended to be on account of the divorce between institutions and their social purpose. It is the tyranny of the dead hand which is our greatest obstacle, and if we can once rise over our dead selves and cultivate the sense of reality, which is the most valuable part of our heritage, our past will come to life again, and will be recognized as our greatest asset in the task of nation building. Our vertical and horizontal divisions will then cease to be separative forces, and the magnitude of our difficulties will become a measure of our opportunities. India's many will become one through a unity which sees no contradiction between the two, and will evolve in a way which will not only be suited to our needs but also to our destiny. If we can achieve national unity through these divisions, we will not only solve our problem, but point the way to the larger harmony of the world. We shall thereby fulfil ourselves; and these divisions will become the distinctions that enrich and not remain the differences that divide.

All this may appear to be metaphysics, and not finance, but it is what may be called the metaphysics of

federal finance which is, in reality, the subject matter of this book. To deal with the problems of federal finance, one has to assume that the future constitution of India will be federal; and it is possible to question the validity of this assumption, and, thereby, call in question the relevance of this enquiry. In fact, it has been suggested that the students who are seeking a federal solution of India's political problems are on the wrong track, and will, if they succeed in their quest, be letting loose on the country the furies of regional and sectional patriotism, which will be our undoing. The word 'federal' covers a multitude of facts and meanings. 'The most striking and pervading characteristic of federation', in the words of Bryce, 'is the existence of a double government, a double allegiance, a double patriotism.' This is the orthodox view of the matter, and one that generally dominates our discussion of the subject. Federations have in the past been brought into being as a grudging concession to the might of circumstances. The federal sentiment is historically a combination of two opposites. Dicey considers it as an essential condition of the formation of a federal state that the inhabitants of the country concerned should not wish to surrender the individual existence of the political unit to which they owe their allegiance; and even postulates the existence of a feeling which implies that 'many of the inhabitants of the separate states feel stronger allegiance to their own state than to the federal state represented by the common government'. A federal state is, according to him, formed when the people desire union but not unity. This, of course, means that a federal state is a political contrivance to reconcile otherwise mutually exclusive sentiments of separation and union; it is a partial surrender of powers by the constituent units to realize specific objects of general importance. It is stern necessity which calls for the adoption of this measure, and only those powers are surrendered which must be exercised by the federation if the union is to be a reality. A federal state is, from this point of view, an intermediary stage in the political development of a people, and a device by which

the way is prepared for a stable and lasting unity on the basis of strong national spirit. It is a half-way house to complete and absolute union, and a landmark in the history of the evolution of large states. This is the general conception of federation; but recent development of political theory and practice have made it out of date, and antiquated. It assigns to the federal form of government a rôle which makes it an historical survival, and is utterly unsuited to modern conditions. The economic changes of the last 150 years have altered the entire basis of social life and set into motion forces which make local or even national barriers obstacles in the way of 'rationalization' of economic and social organization. Integration of economic life is the vital fact of modern social structure, and has brought into play centripetal forces which are making separation of powers a source of conflict and friction in the working of the organic life of the people. The universal tendency in federal states to increase the powers of the central government is evidence of this fundamental change in the existing situation. India can have no use for an expedient which, whatever its historical value, is out of accord with the facts of modern life. She is already a unitary, and within certain limits, a unified state. The present territorial distribution is unsatisfactory; but it is right to assume that, barring the Indian States, the different administrative units have a subordinate place in our political system, and are not considered to have a prior lien on the allegiance of the people. There is not only desire for union but also unity; and though the occurrences of every-day life reveal a state of mutual distrust and suspicion, our problem is communal and not territorial. The communal problem has its territorial aspect, but it may be taken for granted that the latter is not very important, and does not necessitate the adoption of a federal form of Government. Federation, if it is to mean a loose form of union, cannot, therefore, be the right political ideal for us.

The word 'federal' has, however, already acquired a different meaning, and it denotes and connotes a great deal more than a political contrivance with important

historical antecedents. If the Canadian, the South African and the new German constitutions are to be characterized as federal, the word must be used in a sense different from the one in which it was used by Hamilton and Maddison in their essays in the *Federalist*. In the constitution framed by them the powers delegated to the federal government were 'few and definite' and those which remained with the state governments were 'numerous and indefinite', and care was taken to prevent the ascendancy of the federal authorities over the governments of the particular states. The powers of the federal government were intended to be extensive and important in times of war and danger, and those of the state government in time of peace and security. But the federal governments in the recent constitutions are intended not only to be important in times of war and danger, but also in those of peace and security. The constitutions of those countries are federal not because the powers of their central governments are 'few and definite' and those of the constituent states 'numerous and indefinite'. The powers vested in the central government in those countries are, as a matter of fact, wide and extensive and capable of very great expansion without any violation of the letter or spirit of their organic laws; and still their constitutions are, in a sense which is new but nevertheless true, essentially federal in their intent and effects. This brings us to the heart of the problem. Federation is not a scheme of the division of powers, but the means of achieving a synthesis based on the assumption that the differences are essential for unity. This view implies a theory of human nature, a political philosophy, and, in its last analysis, a conception of man's place and function in the cosmic order. It will take us too far afield to make explicit what is implicit in this view of the real nature and purpose of federation or the federal constitution. But it is in keeping with the trend of contemporary political thought, and correctly expresses the significance of the relations between the central and local authorities in modern federal states. The view is gaining ground that the monistic conception of society is essentially

wrong, and 'any theory of society', to quote Laski, 'which avoids complexity will be untrue to the facts it seeks to summarize'. The state cannot exhaust or articulate the sum-total of human experience which seeks expression in associative action. It is not the concrete embodiment of a human 'over-soul' but one organ among others for attaining and realizing the social purpose inherent in the constitution of man. The necessity of 'some single centre of ultimate reference' has to be postulated in a world in which we have to reckon with legal fictions; but the supremacy of the state as an instrument of the organized will of the community is limited by the fact that we live in what is really a multiverse of wills and not a simple universe. These wills have to be integrated; but the unity, which is cardinal for complete self-expression, has to be realized and, therefore, created, and cannot be imposed. Laski applies the word 'federal' to this conception of social organization because, according to him, 'what there is of unity in our relations is not *a priori* there. Our groups do not grow together into a vast monistic whole. We build them together as and how we can'. In the purely political spheres, though according to this view the political sphere does not exist as such, federation is not a temporary expedient rendered necessary by the dominance of particularistic interests, but a vehicle of the fuller life of the community. In this sense, it is not a thing of the past, but of the future. It is an institution which has to express and embody the new political philosophy of the new age and not one in 'which, though the soul has departed from it, the body [thereof] continues apparently to flourish, and retains its social status to all outward seeming unimpaired'. It is not a dream that is dying, but one that is coming to birth. Austria, under the new constitution of 1920, has become a federation of nine states. The Union of the Socialist Soviet Republics consists of six autonomous republics, two of which are themselves federations. The German constitution provides for territorial re-distribution; and, though the Reich has acquired wide powers, the principle of the progressive revision of the territories of the states

has been accepted in order that the new unities may form organic divisions of the Republic. These states are federal not because of the circumscription of the powers of the central government therein, but because their constitutions are based on the necessity of affording the constituent members full opportunities of self-expression. In 1803 Napoleon, in opening the Council of Switzerland, which had been set up by him, envisaged her political future in the following words :—' Switzerland resembles no other state in regard to its history, its geographical and topographical position, its languages and religions, and lastly its extraordinary diversity of customs and manners. Nature has made you for a federal state ; no wise man will run counter to nature.' The *raison d'être* of federation lies not in the existence of mutually repulsive forces, but in the variety and wealth of differences. India has to realize a multiple unity. The vastness of our country and the diversity of its parts make it inevitable that our political system should be essentially federal in order that our resources—economic, social and intellectual—may be fully developed. We have to realize the federal ideal not only in our political life but also in our entire social structure. This has to be done in every country ; but more so in India, on account of the vital needs of our national life and the facts of history. This ideal is the modern version of the ancient ideal of *Svadharma*. We have lived it through the ages, and have to live it again in order to fulfil ourselves. Atrophy of our institutions makes it exceedingly difficult for us to organize our national life on this basis. We have to revive it not on account of its antiquity, but because of the imperative necessity of the hour, its supreme value and importance as a means of expressing the genius of our people, and the utter futility of centralization. India has to be a federal state, as the facts of history and needs of our national life make it impossible for us to adopt any alternative method of solving our constitutional problems.

If the validity of this view is granted, it makes it easy for us to understand the real issue between those who advocate the view that residuary power should reside in

the Central Government and those who want to make the Provinces the repository of this authority. The question is not really important in the sense in which it is commonly understood. The advocates of vesting it in the Central Government are anxious to provide safeguards against disintegration. The danger of centrifugal forces undermining the foundations of national unity is real. The centripetal forces are working everywhere, and are likely to grow in importance and efficacy in the future. But India cannot take any risks in the matter. It is necessary to promote cohesion of the parts and to foster the habit of subordinating local interests to the interests of the entire body politic. Really speaking, the choice is not between interests but values. People should be taught to view things in their right perspective, and it is, therefore, important that their horizon should not be limited by their local environments. It is, however, necessary to appreciate the misgivings of those who propose to place the centre of gravity of our political life in the Provinces. They are afraid lest the Central Government should disregard the view-points of the Provinces altogether, and impose upon them measures and policies repugnant to their corporate life. The Central Government may unduly rely upon its coercive powers, and enforce decisions upon the Provinces, obedience to which may entail sacrifice of their cherished convictions. The exercise of residuary power by the Central Government may be used to the detriment of the Provinces. There is a possibility of the Central Government acting in a high-handed manner; but if the federal principle is rightly understood, and consent is accepted as the basis of political authority, the Central Government will have to keep in view the limitations imposed by its responsibility, and, therefore, the limits of its powers. It should, of course, have the constitutional right to maintain the conditions necessary for the exercise of its functions, but for that it should depend upon the co-operation of the constituent units and not upon its statutory powers. The right point of view is not to think in terms of powers but functions. 'The question of local and central government is not,' as

Mr. G. D. H. Cole has put it, 'in fact, primarily a question between federation and decentralization, but a question of right allocation of social functions'. There is not, in practice, any real difference between a federation and what is called a decentralized unitary state. Both serve the same purpose and perform the same functions. 'The relation between larger and smaller bodies of the same kind', to quote from Mr. Cole once more, 'is increasingly defining itself in terms not of powers alone, but of powers in relation to functions'. The question of the residence of residuary powers is more a question of jurisprudence than of political science or practical policy. Empirically, it is a matter of indifference from what source the smaller political units derive their authority. The fact that here it is for the Government of India to give and the Provinces to receive need not make any difference so far as the essential working of the constitution is concerned. Centralization is an advantage in constitution-making in as much as it is possible to devise a political arrangement suited to our needs, unembarrassed by the existence of independent political states. There are no political rights that are sacrosanct except those which have to be vested in the Central or Provincial Governments to give free play to the vital forces of our national life. The only interests that need be taken into account are the interests of the future. But the limits within which the Central Government has to function have to be clearly recognized. It cannot impose its authority on the Provinces, it must demonstrate its utility as an institution charged with the duty of co-ordination. It may be pre-eminent, but cannot be supreme in the working of our political constitution. It may, from the point of view of the constitutional lawyer, be the centre of ultimate reference, but cannot be omnipotent or omnicompetent. The limitations are, as already stated, inherent in the facts of our national life and the conditions essential for its free and unhampered development.

The foregoing discussion is germane to our enquiry. The objection that a discussion of the problem of federal finance presupposes that India is going to have a federal

constitution is met by the consideration that no other will and can suit Indian conditions. Decentralization is a measure of federation, and carried far enough will give us a constitution which will possess all the essential features of a federal system. A scheme of federal finance must fit in with our political constitution; but it is the division of functions and not of authority or powers which is vital for a satisfactory financial settlement. It is, therefore, safe to assume that it will be necessary to frame a constitution whose financial counterpart can be characterized as federal without raising the issues of the residence of residuary powers, or other cognate questions. In matters of finance, the integration of economic life has everywhere altered the very basis of the relations between the central and local authorities; and the central government, in every federal state, has had to assume wide financial powers to ensure the co-ordination of financial policies and avoid a duplication of efforts and a conflict of jurisdictions. The importance of viewing the question of financial re-adjustment from what may be called a realistic standpoint is greater even than in the case of constitutional re-adjustments. The Provinces need to be assured of two things. They must, in the first place, have adequate and expansive resources to discharge their dynamic responsibilities. The progress of the country will in a very large measure depend upon their enterprise in matters that are really vital for the well-being of the community, and their enterprise will be very largely conditioned by funds at their disposal. The failure of the Reforms is often attributed to the financial settlement. The difficulties inherent in the Reformed constitution and the peculiar political conditions of the country have as much to do with the disappointing result of these constitutional changes as the financial arrangements incidental to them; but this experience points to the necessity of working out the financial proposals with greater care, and making provision for the development of the economic and social resources of each Province. The other condition which has to be satisfied is that the Provinces must have financial autonomy. They must have adequate

funds, and freedom to spend them in their own way. This freedom has already been conceded to them within very wide limits; and if certain consequential changes are carried out, the Provinces will be in a position to shape their own policies according to their judgment of what is right and desirable. The scheme of re-distribution of resources and financial re-adjustments must provide for adequate and buoyant revenues to the Provinces, and give them final powers over their budgets. The constitution which ensures that the Provinces will be given the largest measure of independence, legislative, administrative and financial of the Government of India which is compatible with the due discharge by the latter of its own responsibilities as an organ of the common life of United India, and the resources to use that independence to secure the benefit of continuous progress will be federal in theory and practice, and can be made the basis of a scheme of federal finance. The division of political functions into static and dynamic is convenient, though it does not give us a really satisfactory differentia for classification, and the Provinces will have to be in charge of the dynamic functions under the new constitution, as they are even under the existing one, and will have to be provided with the wherewithal to discharge their responsibilities efficiently and well.

A scheme which will answer the real needs of the future cannot be devised on the basis of a correspondence between the incidence of costs and benefits. Between the Provinces, as between individuals, these costs and benefits are incalculable and indivisible; and we have to proceed on the basis of the well-known communistic formula 'From each according to his capacity, to each according to his needs'. It is necessary to provide conditions, which may foster the sense of responsibility among the Provinces, and give them an incentive to develop their own resources to the utmost limit of their capacity. It will not do to create hopes which may weaken the habit of self-reliance and self-help among them or lead them to depend upon largesse for the funds required to finance their activities. The system

under which the Provincial Governments depended upon doles out of the Indian surplus for what the authors of the Joint Report called 'large and costly innovations', can have no place in a scheme of federal finance. But it is not possible to allocate fairly the contributions of each Province to the central exchequer, or to assess its taxable capacity with a view to formulate proposals for giving it a share of the receipts of the central heads of revenue. Inter-provincial jealousies have to be avoided; but if this is to be done by making each Province depend upon those resources to which it can be considered to have an exclusive claim, the task cannot be accomplished. The growing unity of economic life and the difficulty of tracing the origin of income has in most cases rendered that impossible. Bengal and Bombay have been urging their claims to more favourable treatment on the ground of their large contributions to the central revenue. The incidence of customs is very widely diffused; and the claim of the Provinces, in which their receipts are collected, to special consideration on that score obviously cannot be substantiated. But, even in the case of income-tax, it is not right to maintain that the receipts in each Province properly belong to it. Calcutta and Bombay are all-India cities; and apart from being the headquarters of a large number of firms which are carrying on their operations in other Provinces as well, their economic position and prosperity have a national basis and the Provincial Governments of Bengal and Bombay cannot establish a right to the exclusive economic allegiance of the residents of these great industrial centres. This fact makes it necessary to approach the problem from a different standpoint. The allocation of revenues will have to be made on the consideration of the needs of the different political authorities in view of the functions which are to be assigned to them. The one outstanding fact of the existing situation is that the different Provinces are at different stages of development; and it is not possible for them to keep pace with one another. This disparity is partly due to natural causes. The difference in the physical endowments and native abilities of the people accounts for the difference in their material equipment. These differences

have, however, been accentuated by the differential treatment accorded to some Provinces during the long period of financial centralization. This aspect of the matter will be further considered in the next chapter, but there is not the slightest doubt that the distribution of funds from the central purse has not been fair or equitable in the past; certain Provinces have received less than their due, and their backward position is due not so much to their fault as their misfortune. It is evident that this disparity is an extremely undesirable feature of our national life and has to be redressed in the interests of the healthy and all-round development of the entire country. The backward Provinces, like the backward communities, are a national responsibility, and their levelling up must be a charge on national revenues. This would be so even if all the Provinces had been fairly treated by the Central Government in the past; but in view of the fact that some Provinces owe their comparative backwardness to the sins of omission and commission of the Government of India, it is a matter of the utmost importance that in the financial re-adjustments the national standpoint should have precedence over the interests of the individual Provinces. The problem of federal finance cannot be solved in any calculating spirit. It is a task for fiscal architects with imagination and vision, and not for expert accountants or competent statisticians.

In the re-allocation of revenues it will be necessary to have some guiding principles. The one referred to in the preceding paragraph is of great importance. The present financial settlement has been influenced and shaped by considerations other than those relating to the needs of the Provinces. This defect will have to be remedied. But there are other important considerations which have to be taken into account in making the necessary financial re-adjustments. The Australian Commission on Taxation of 1923 recommended that a scheme of allocation of resources should comply with the following conditions, viz.

1. It should not have any tendency to weaken the federal spirit.
2. It should be capable of early application.

3. It should, in the first instance, be by voluntary agreement between the Commonwealth and the States.

4. It should be reciprocal.

5. It should not involve the financial embarrassment either of the Commonwealth or any State.

6. It should sensibly reduce double taxation, the duplication of effort, and the unnecessarily large expenses involved in the existing system.

7. It should attach to the respective authorities the spheres of taxation which seem most appropriately to belong to them.[1]

The recommendations of the Australian Commission were, of course, framed to solve the Australian problem ; but they are, perhaps with the exception of conditions (3) and (4), of general application. They are applicable to India, and as a matter of fact to every federal state which may be on the eve of radical constitutional changes. The history of public finance in all federal states points to the necessity of making provision for what the Australian Commission calls the harmonization of taxation. A conflict of jurisdiction in the domain of finance not only impairs efficiency of administration and gives rise to the evils of multiple taxation, but also weakens the sense of national unity and leads to acute development of local patriotism. A fiscal reformer can never have a clean slate to write upon. The facts of history, which may be embedded in the political structure or the system of administration, have to be duly considered and allowed for in all schemes of financial re-adjustment. The consideration relating to the avoidance of financial embarrassment has both positive and negative aspects. The scheme of re-allocation should not only involve dislocation of administration or necessitate the adoption of radical measures but should also provide for the expansion of beneficial activities. In the sphere of finance, co-ordination is even more necessary than in other spheres of administration. The respective authorities must, of course, be in charge of the sources of

[1] See *Second Report of Royal Commission on Taxation*, p. 79.

revenue which most appropriately belong to them; but it is not possible to avoid an overlapping of the orbits of their financial operations under modern conditions. The Central Government may have to exercise general supervision in the assessment or collection of certain taxes, which may otherwise be properly assigned to the Provinces, or assume charge of the administration of others to prevent friction among the different taxing authorities, or promote harmony and efficiency in the working of the tax-system as a whole. The Provinces must, of course, have each a fiscal system of their own, i.e. they must be in a position to vary the rates of taxes they impose or even determine the choice of taxes themselves within certain limits; but if the tax burden is to be evenly and equitably distributed, the general structure of the tax-system should be based on the same fundamental principles everywhere in order that the integrity of the system as a whole may not be disturbed by the adoption of ill-considered or ill-administered fiscal measures on the part of the different taxing authorities. It is a commonplace of writers on fiscal science that equity in taxation can be realized only through the tax system as a whole and not through a particular tax or taxes imposed by particular authorities. It is not easy to incorporate an ideal of equity in a tax-system, when the development of the latter is in the hands of authorities who enjoy a considerable latitude of action within the spheres assigned to their special care; but as there is only one way of achieving this pre-eminently desirable object, it is absolutely essential to provide safeguards against the intrusion of disturbing elements in the scheme for the allocation of resources. Seligman has laid down three general principles for making a permanent choice of revenues for the competing tax jurisdictions. He calls them the principles of efficiency, suitability and adequacy. If to these is added the principle of integrity, they ought, if widely interpreted, to afford general guidance in solving the problem of the division of resources between the Central and Provincial Governments.

The present territorial distribution of the Provinces makes it exceedingly difficult to develop a sound system

of federal finance. The division of the country into Provinces is a purely arbitrary one, and the result of historical accident or considerations of administrative convenience. There is no rational basis for it, and to argue the question of the division of resources as if each Province were a sub-nation, which ought to be financially self-supporting and develop into a self-contained fiscal unit, is contrary to the facts as we find them. The re-distribution of Provinces is inevitable ; but the prospect of the present defective system being remedied at an early date is somewhat remote, and the Provinces will continue to be fortuitously composed administrative units, and provision will have to be made for the division of the country into more homogeneous parts on the basis of the organic divisions of national life, when later developments make it possible to carry out this task without creating further complications. The only logical basis of distribution which has so far been suggested, besides, of course, the wishes of the people concerned, is the division of the country into linguistic areas. 'Language,' in the words of the Nehru Committee, 'as a rule corresponds with a special variety of culture, of traditions and literature.' It is a bond of unity, and a means of self-realization. The fact that most of the Provinces are polyglot is a hindrance in the way of their organic development, and makes it very difficult for the soul of the people to find opportunities of self-expression. The national renaissance must carry with it the full development of Indian languages, and will realize its possibilities only when each linguistic area is vitalized into a self-conscious cultural unit. But it is not possible to attain this object in the immediate future, and it may not even be necessary to equip each linguistic area with all the requisites of a self-contained administrative unit. There is, it has to be admitted, a danger that by accentuating linguistic unity we shall be creating a linguistic patriotism, and dividing the country into Provinces which may not be in a position to command adequate resources for the efficient discharge of the functions assigned to them as organs of national life. There are at present twenty-two languages which are spoken by over a million persons,

and the areas inhabited by these persons can very well be constituted into separate Provinces, if the linguistic test is to be adopted as valid and conclusive for this purpose. But the huge Hindi-speaking block cannot be constituted into one Province. It is too big to constitute a single unit in our political system. There are other linguistic areas, like the Kerala and Karnatak, which cannot be given a distinct political status on account of the population of these territories being divided between the Indian States and British India. The suggestion that there should be a few big Provinces, comprising a number of sub-provinces, is probably more in line with the natural political evolution of our national life; but this process will most likely follow and neither precede nor accompany the inauguration of the new constitution. The authors of the Joint Report considered it unwise to unite the difficult task of revising the constitution of India with the highly controversial one of simultaneously revising the political geography of the entire country; but they were of opinion that the redistribution of Provincial areas was necessary, and regarded it as one of the earliest duties incumbent upon all Reformed Provincial Governments to test Provincial opinion on schemes directed towards such an end. It was in pursuance of this recommendation that provision was made, in Section 52 (a) of the Government of India Act, for reconstituting a new Governor's Province or placing a part of a Governor's Province under the administration of a Deputy-Governor. But since then nothing has been done in this respect; and even the possibility of instituting sub-provinces in Orissa and Berar, the necessity of which was admitted in the Joint Report, has not been seriously considered. It is not possible to carve out Provinces, according to any theoretical scheme, as a part of the next constitutional re-adjustments; but the obligation to constitute linguistic or racial units of administration later on will have to be imposed on the Government of India. The whole situation is full of numerous possibilities, and the ultimate result cannot be forecast. The conclusion, of course, is that, difficult as it is to have a satisfactory scheme of federal finance

with the present distribution of Provinces, it is not possible to introduce a scheme of Provincial redistribution in the immediate future. It is necessary to take a realistic view of the situation, and to try to fit theory to facts and not facts to theory.

If this conclusion is correct, it naturally follows that we have to proceed experimentally, make tentative arrangements for the immediate future, provide for intermediate steps to make transition to the new order gradual and easy, and retain the freedom to make changes which may be desirable and necessary in the light of later developments. The past has to be liquidated and the future anticipated without overlooking the limitations of the present situation. The problem of federal finance has everywhere assumed a new form, and is making it necessary for practical financiers to break the old moulds. They are, however, proceeding cautiously, and on the assumption that the future has still to reveal itself and is full of possibilities which cannot be even clearly envisaged in the existing circumstances. The re-adjustments, the urgent need of which has to be admitted, have, therefore, to be made without incurring any unnecessary commitments. In India the situation is even more obscure than in other federal states, and the vision of the future has to be qualified by a proper sense of reality. We have to devise arrangements which may be flexible and capable of being modified without much difficulty. Even our political constitution should not be unduly rigid ; but its financial counterpart must unquestionably be based on empirical considerations, and have within itself the seeds of growth and the power of adaptation to future changes. The financial arrangements should, in view of this all-important consideration, be essentially provisional and definitely provide for periodic stock-taking. Some short-sighted public men have suggested that the distribution of Provinces should be made on the lines which commend themselves to their judgment, and declared unalterable under the new constitution. This suggestion and others similar are inspired by a dread of the future, and its unknown consequences. In an atmosphere of mutual

distrust and suspicion, it is natural that each party should first seek to drive a bargain profitable to itself, and then put on it the seal of finality in order that the future vicissitudes of political fortune may not upset the present equilibrium of interests. But it has to be realized that the future will make ever greater demands on our creative craftsmanship, and it will be exceedingly unwise to bind ourselves to any permanent settlement of this kind. We have to allay all reasonable doubts and suspicions, and make gerrymandering in the future as difficult as possible; but we shall be laying in store for ourselves serious troubles and acute dissensions, which may even lead to the evils of civil war, if we declare sacrosanct any arrangement whatsoever that may otherwise be suitable to our immediate needs and convenient on account of being based on a large measure of general consent. What is true of all constitutional changes is, of course, particularly true of financial changes. There can be no finality about them. They must, in order to be workable, be sufficient unto the next step, but should be no more than that. It is necessary to remove the anomalies and inequalities of the existing arrangements. They cannot be combed out all at once; and any measures that may have to be adopted will have to be determined by considerations of expediency, and must be provisional on that account. It will also be necessary to stimulate the Provinces to fresh fiscal enterprise, and make it worth while for them to tap new sources of revenue. The general belief that the limit of the taxable capacity of the people has already been reached, if not actually exceeded, is based on a well-grounded conviction that public expenditure under present conditions is wasteful in the extreme, and involves what is really a deadweight burden on account of its sterile character. But it will be necessary to change the fiscal outlook of the people and to educate them into appreciating the real nature of public expenditure. It will have to be realized that beneficial public expenditure is the best form of national investment; and unless the Provinces are to be doomed to stagnation, it will be necessary for them to impose fresh taxation. It will, however, take time before the yield

of the new taxes is stabilized and their position in our fiscal system ascertained with any degree of accuracy. In the meanwhile, the Provinces will have to be provided with sufficient funds to undertake progessive measures for the development of the people. The arrangements by which the Provinces can face the immediate future with hope and confidence, and develop habits of self-help and enterprise, must necessarily be flexible. They will be based on certain hypothetical considerations, and it will be for the future to measure the extent to which the hypotheses agree with actual facts. India has to develop into a federation of federations. That is to be her political goal, but it must be reached by progressive stages; and though the time and measure of each advance must be determined by the judgment of our own people, they will be guided by practical considerations in taking each step, and their willingness and ability to go ahead will, in no small measure, depend upon financial considerations. It will, therefore, be necessary to embark on this political venture without any prepossessions or encumbrances. The next step is to be the first of a series of similar steps, and must be taken in a manner which may leave future generations free to solve their own problems. The Permanent Land Revenue Settlement of Lord Cornwallis is now generally characterized as a monumental blunder. The disillusionment of the thinking section of our people, which has taken place in recent years, as regards the real nature and effects of this measure, has a very important lesson for us; and that is, that in making our financial re-adjustments, the worst mistake that we can commit is to assume that all the major problems of federal finance are to be disposed of by us once for all, and that coming generations will only have to proceed on the lines chalked out for them. Any assumption of this kind is absolutely unwarranted, and betrays our ignorance of the essentials of federal finance. Attempts have to be made to rectify the mistake of 1793; but it is a matter of common knowledge that the redress of this historic wrong calls for an uncommon degree of political courage, and carries with it risks which incline many to

argue that this act of fiscal redemption is really not practical politics. It is always difficult to undo the past or make amends for past failings. In laying the foundations, therefore, of our system of federal finance and, in providing for its development, we should fix our gaze steadily on the future, and keep the system plastic. The political horizon just now is full of so many signs that he will be a bold soothsayer who can divine all that they mean. Transitional arrangements are necessary in order to enable the new constitution to find its financial bearings by actual experience; and, above all, we must avoid creating fresh obstacles in the way of future re-adjustments.

The financial settlement should be comprehensive and cover problems other than that of the re-allocation of revenues. A solution of the problems relating to expenditure, borrowing, audit, balance and resource operations, has to be made an integral part of the financial settlement. We have suffered so much from centralization in the past that we are likely to go to the other extreme, and underrate the importance of providing for the co-ordination of various public activities. We have to take into account the all-important fact that growing economic solidarity has made it necessary for the central governments in all countries to assume the responsibility for stimulating and guiding the development of certain vital activities of the state. If it is realized that it is on account of the necessity of securing the greatest possible efficiency in the working of the political system, and not from the standpoint of relative power or authority, that the problem of the division of functions is important, we shall appreciate the necessity of enlisting the interest of the Central authorities even in the functions which may normally be assigned to the Provincial Governments. They should not be precluded from spending from the Central resources for purposes like education, public health and industries, though the possibility of an undue encroachment on Provincial spheres has to be carefully guarded against. They may even have to set the pace in certain cases, which the Provinces will be expected to keep up. At any rate,

rigid demarcation of the two spheres of activities is to be deprecated; and it should be possible for the Central Government to finance measures necessary for the purpose of co-ordination. In other matters the unity of the financial system as a whole is to be secured without thereby introducing centralization of powers. It is not possible to make the different political units autonomous in the sense of isolating their operations and giving to each a completely independent orbit of activities. In the sphere of finance, even more than in other spheres, errors of policy and practice are bound to have far-reaching, though inscrutable, reactions; and it is necessary that certain fundamental principles, or what are called canons of financial propriety, should be considered binding on all political authorities in the country. The use of public credit carries with it risks of its own, and it is a matter of very great importance that borrowing powers should be exercised with due regard to the needs of the country as a whole, and hedged with restrictions which may make a reckless increase of public debt really a very remote contingency. The money market in India is, and for a long time will remain, sensitive; and it will be necessary to protect it against the stress of competitive bidders or an indiscriminate use of borrowed funds. These aspects of federal finance are not likely to attract much attention, but are, nevertheless, very important, and have to be carefully considered in schemes of financial readjustment.

The Indian States present problems of their own; but it is now generally admitted that they have to find a place in the political system of the country. The frontier between the Indian States and British India is really an imaginary line, and it is not possible to set up barriers which may make the former proof against the dynamic forces now working in the latter. They are already subject to the same influences, and the trend of events must draw them still closer into what the authors of the Joint Report called 'the orbit of the Empire'—a phrase which really means the ambit of the larger life of the nation. The Indian States cannot possibly keep out of the new constitution, or establish independent relations

with the Crown; for they will inevitably be drawn into a close and living contact with the Central Government of a self-governing India. They are anxious to safeguard their treaty rights and keep intact their internal autonomy. In their case, it is true, the necessity for devising a federal constitution for India arises on account of the existence of a double government, a double allegiance and a double patriotism. They have certain vested interests which, within the limits set by the paramount necessity of providing for the development of the common life of a united India, have to be duly respected. The States are historical survivals; but it cannot be assumed that they have had their day. Their Governments have to be democratized. Personal rule, which is such an outstanding characteristic of their polity, has to be tempered by the recognition of the political rights of their subjects. But they cannot be regarded merely as Provinces in the Indian political system, and must have a distinct and well-recognized position of their own. They will enjoy a larger measure of independence of the Government of India than the Provinces, and will even be allowed to retain certain privileges which, whatever their intrinsic importance, they have learnt to cherish as the insignia of their higher political status. But, in all matters that are vital, they will have to fall into line with other parts of the country as a whole, and appreciate the necessity of putting the interests of the nation above their own particular interests. The ties—racial, social and economic—which bind them to British India are strong and indissoluble; and they cannot stand aloof from the universe of our political life.

It is in financial matters that the Indian States feel the hand of the Paramount Power lying most heavily on their internal sovereignty or autonomy. In dealing with these questions, it is not the business of practical statesmanship to raise the issue of their precise political relations with the Government of India. The usages and conventions, which have grown up under the stress of compelling circumstances, have already considerably modified their original position; and if the necessity of specifically providing for the harmonious adjustment of mutual relations

is conceded, it will be possible to get away from legal fictions and discuss the outstanding questions of financial re-adjustment between British India and the Indian States in an atmosphere of reality. It will not do merely to state that in these matters, as in all others, the Central Government of a self-governing India shall exercise the same rights in relation to, and discharge the same obligations towards, the Indian States as the Government of India exercises and discharges under the existing conditions. The present rights and obligations of the Government of India with regard to the Indian States are not at all easy to define, and are not based on any intelligible principle. The whole situation is not only obscure, but is the outcome of what is really a fortuitous concourse of events; and though the need of ensuring the harmonious development of the whole country has been a very important determining factor in the compromises which have been adopted, it is not possible to deduce any regulative principles of general application from the analysis of the usages and conventions on which the existing relations are based. The anomalies and contradictions of the situation are far too numerous to make it possible for constitution makers to take the *status quo* as the basis of the new order. It is necessary to discuss the whole question from the standpoint of the future, and enunciate certain principles governing the reciprocal relations between British India and the States, which may leave no doubt regarding the intent and the purpose of the new conventions. In the past, the premise of the suzerainty of the British Government has often been used to impose arrangements on the Indian States which they would not have accepted if the matter had been left to their free choice. The supreme authority of the Paramount Power has been exercised in an arbitrary manner, and the Princes have had to submit to its decrees on account of their helpless condition. It is to be recognized that, as between British India and the Indian States, the obligations are bilateral, and financial re-adjustments must take into account the interests of the States as much as those of British India. But more important than the consideration of justice is the

paramount necessity of laying the foundations of internal national unity truly and well, and providing against all stresses and strains of the body politic. India cannot be a house divided in itself, and it is as much in the interest of the Indian States as that of British India that the supreme importance of this elementary fact should be admitted. It is not possible to make radical changes and ignore the past altogether; but we have to safeguard the economic integrity of the country on which, of course, the structure of political unity must ultimately rest. A scheme of federal finance which leaves out the Indian States will not only be incomplete, but also unworkable. It is, therefore, absolutely necessary to realize that in financial matters we have to adopt measures which may both be fair to the parties concerned, and embody principles of national unity. The solution of these questions must be worked out on the basis of matter-of-fact considerations, and the complications suggested by the sophisms of jurisprudence have, as far as possible, to be avoided. The problem is, as the Nehru Committee has rightly pointed out, not a problem for the constitutional lawyer but one of constructive statesmanship.

There is a disposition in some quarters to treat these financial questions as minor issues and hold over their settlement till the more important problems of the devolution of powers and other constitutional problems have been solved. For a nation striving for freedom, the one thing that matters is emancipation from foreign domination, and other considerations must be of secondary importance. It is natural for our public leaders to concentrate all their energies on the problems of political strategy, and to take it for granted that when the time is ripe for decisive action, and the nation's freedom is within sight, it will be possible to find a solution of the problems of financial re-adjustment. The Nehru Committee has recommended the appointment of a commission immediately after the establishment of the Commonwealth to institute an enquiry into the sources of revenue, which may be assigned to the Commonwealth and to the Provinces, and into the

financial relations between the Central Government and Provincial Governments. It is wise to put off the financial settlement if we are to take the recommendations of the Nehru Committee or any other proposals for constitutional changes as preliminary efforts in constructive thinking, and if they are not made on the assumption of the imminence of our political freedom. But if we believe in the early advent of the era of self-government and have to prepare ourselves for assuming full responsibility for running the government of our country, we have to address ourselves seriously to financial problems and to try to find a solution which will answer the needs of the immediate future and pave the way for an orderly development of our financial system. In one sense finance is an incident of administration, but in another and a more real sense its fundamental basis. It is not possible to settle the political issues without the settlement of our outstanding financial problems. It is, as already stated, not possible to put the stamp of finality on the scheme of federal finance which it may be advisable or practicable to adopt as a part of the next constitutional adjustment. Our scheme will, as a matter of necessity, have to be made provisional, and suitable changes introduced later on to keep it in harmony with the evolution of the political system. But we shall have to make a working settlement before we take the next step, and to base it on sound principles and a large measure of general consent. Money furnishes not only the sinews of war but also the sinews of peace; and the success of the new constitution will, to no small extent, depend upon its financial counterpart.

The plan of this book is determined by practical considerations. The problem of federal finance in India has a history of its own, and proposals for financial re-adjustment cannot be understood, nor different aspects of the issues involved appreciated, unless their historical background is borne in mind. It will, therefore, be necessary to explain the present position in detail with reference to its historical setting, and to set forth the outstanding issues after an analysis of the basic facts of what is known as the Meston Settlement and its later

developments. It is also necessary to know something of the systems of finance in other federal states. In India, the situation is the reverse of that which had to be faced by constitution-makers in other federal countries, and we have, therefore, to beware of facile analogies drawn from federal systems; but the problem of the financial relations between the Central Government and Provincial Governments can very well be compared to those of the financial relations between a federal authority and its component parts; and it will be useful to know the methods by which these problems have been solved in other countries. A survey of the existing situation in India and of the systems of finance in other federal states will lead to a discussion of the possible lines of development in India, and of the remedies for removing the inequalities arising from the present distribution of resources. It will also be necessary to bring under review questions other than those relating to the re-allocation of resources, and to discuss the relative merits of the different methods of placing the financial relations between the Central Government and Provincial Governments on a sound basis. It is not possible to attempt anything like an exhaustive consideration of the question of the financial relations between the Indian States and British India; but the general lines on which a solution of these questions may be sought will briefly be indicated. In conclusion, the necessity of taking an all-India view of our financial questions will be stressed and the futility of developing a system of independent and self-sufficient fiscal units pointed out.

## CHAPTER II

### *History of Provincial Finance*

The problem of fiscal re-adjustment between the Central and Provincial Governments has a history of its own. As the new constitution is to be based on assumptions entirely different from those which have determined our political evolution in the past, it is not necessary to revive the old controversies or unduly stress the mistakes which have been committed, and which could, with greater foresight and care, have been easily avoided. But it is not possible to bury the past altogether. It has an important bearing on the present and the future, and cannot be completely left out of account. It is not dead as yet, and will, for years to come, continue to be a living factor in our financial affairs. It is seldom given to a nation to make a fresh start by wiping the slate clean; in India we cannot possibly expect to liquidate the past immediately. The process will take time, and an attempt to cut the Gordian knot, when we cannot untie it, may be heroic but will not contribute to the efficiency or harmony of fiscal relations. It is, therefore, proposed to deal with the history of the question briefly in this chapter, only to the extent to which it is necessary to do so, to understand the present position.

It has already been pointed out that the outstanding characteristic of the present situation is the financial inequality of the Provinces. This, of course, means that it is not possible for them to come into line with one another for a long time to come nor to maintain the same pace of progress. This is unfortunate, but cannot be helped, on account of the difficulties inherent in the facts of the case. There are two aspects of the matter, the importance of which has to be properly appreciated. The first is that this disparity of development is extremely

undesirable from the national standpoint. It is unnecessary to dwell at length upon this point. Its importance is self-evident. The Provinces must march together. It is not in the interest of the nation to let one or a few of them lag behind the rest in their onward journey. It is wrong for any Province to develop parasitical tendencies or expect to be provided with the means of carrying out progressive policies at the expense of other Provinces. But it is necessary to ensure the attainment of a national minimum in our public administration; and the emergence of what the geologists call 'fault' in the constitution of the body politic has to be provided against. The other aspect of the matter, which is more important for our purpose, is that these inequalities are, to no small extent, due to historical causes. Their origin can be traced to the years of extreme centralization; and, what is more, no attempt has ever been made to redress the inequalities or devise measures for levelling up the Provinces. The successive settlements were not only made on the basis of existing facts, but also accentuated these differences, and have made the task of the fiscal reformer extremely difficult. The anomalies of the past were taken for granted, and to them more were added on account of the inability of the Government of India to make an equitable apportionment of common resources. At times, the Central authorities had to levy benevolences, at others to distribute doles, according to the exigencies of finance or the results of a gamble in exchange or in the rains. But in years both of stringency and plenty the Government of India found themselves face to face with a very difficult situation, and did not act upon any rational or intelligible principle in handling it. They followed the line of least resistance which, of course, was very convenient for them, but did not lead to the observance of principles of equity or even-handed justice in the assignment of funds to the Provinces. An attempt must now be made to rectify these mistakes, as far as possible, in the interest of the Provinces which have suffered from unmerited neglect in the past and also of the paramount need for the organic development of the country as a whole. A knowledge of

the historical background is necessary in order to appreciate the nature and extent of this disparity. What are really, historic wrongs have to be righted; not to square up old accounts, but to provide conditions necessary for the healthy and all-sided progress of the nation.

This historical narrative makes the use of figures necessary. They are given in tables at the end of the book, and index numbers of expenditure will be found facing the pages to which they relate. They are further illustrated by diagrams for the benefit of those who have an innate prejudice against the use of figures. These figures have been analysed with a view to explain the existing facts, and only those figures have been compiled which are relevant from this point of view. The financial settlements till 1919–20 were based on needs and not on revenues, and the revenues were assigned on the basis of the estimates of the requirements of the Provinces. The figures of expenditure on subjects which are of primary interest to the Provinces, and have, since 1877, been under the control of the Provincial Governments, are given in the tables; and though the figures of the total revenue and expenditure of the Provinces have also been given, they are of secondary importance. The question of control is, as a matter of fact, comparatively unimportant, as the Government of India exercised wide and extensive powers of control even over so-called Provincial subjects of administration till the introduction of the Reforms. The distinction between Imperial and Provincial expenditure is not of much consequence so far as the growth of expenditure on these subjects is concerned.

The year 1833 is, as is well known, an important landmark in the history of Indian administration and public finance. British India became in that year, by the Act of 1833, 'one sole grand Power in dependence on Great Britain, having undivided interests, a single exchequer, controlled in all essential and general principles by one Government, 'the Governor-General in Council'.[1] This, of course, led to extreme centralization in administration

[1] The G.O.I. F. D. Resolution, dated 22 November, 1843.

and finance. The Government of India were vested with the powers of superintendence, direction and control of the whole civil and military government, and were given to understand that for 'what was good or bad in the administration of it, the honour or dishonour would redound upon them'. The Court of Directors recognized the necessity, of drawing a correct line between 'the functions which properly belonged to a local and subordinate government and those which belonged to the general government ruling and superintending the whole', but found it impossible to define the exact limits between 'a just control' and 'a petty, vexatious, meddling interference', and left it to the practical good sense of the Governor-General in Council and other Governors to carry the law into effect in a manner consonant with its spirit. In practice, however, the Government of India exercised a control which was as far-reaching as it was extensive, and had a paralyzing effect on the enterprise and resourcefulness of the Provinces. The figures of expenditure in 1857–58 on different services in the various Provinces are given in Table I. Their value for a comparative view of provincial finances is practically very little on account of the existence of entirely different conditions and of changes in the system of accounts. They are given for what they are worth.

In 1861 the financial, as apart from the legislative, control of the Central Government over the Provincial Governments was not modified in any way, and centralization continued to be the most conspicuous and basic fact of the Indian administration. The revenues of the Government of India were treated as constituting one undivided fund and applied for the purposes of the Government of India as a whole. They exercised sole control over the entire Indian revenues and were alone liable for all the demands that could be made thereon. The Provincial Governments had to apply to the Government of India for the means wherewith to satisfy local needs, and for their guidance had no authoritative ruling as to the limits within which they were to keep their total expenditure or expenditure on any one department. The Provinces, as was natural,

took a parochial view of the financial situation, and asked for as much as they could for the needs, to whose urgency and magnitude they were fully alive, but whose relative importance they were not in a position to judge on account of their ignorance of the requirements of other Provinces or of the country as a whole. The Government of India, on the other hand, could not exercise an effective control over provincial expenditure on account of their ignorance of local conditions, in spite of the fact that every addition to expenditure, however trivial, had to be sanctioned by them. The distribution of funds was not and could not be effected according to any fixed or intelligible principle, and the expenditure of the Provinces was determined, not by their resources or requirements, but by the degree to which they were clamant in pressing their demands on the Government of India. The result, in the oft-quoted words of Sir Richard Strachey, was that 'the distribution of public income degenerated into something like a scramble, in which the most violent had the advantage, with very little attention to reason'. The centralized system of finance gave rise to anomalies of a very glaring character, and put a premium on qualities which were incompatible with the ends of economy or with equity in the working of the administrative or the financial system of the country. The system had all the defects of the joint-family system without its redeeming features. The sense of community of interests was conspicuous by its absence, there was irritation and heart-burning, and the beneficiaries of the arrangement were not the weakest units of the political organization.

It was not long before the defects of the system became manifest. The finances of the Government of India from 1860 to 1870 were subjected to a very heavy strain. In spite of additional taxation and retrenchment, it was found difficult to balance the annual budgets, and time after time proposals for relieving the Imperial Treasury by imposing local taxation for local needs were made; but on account of the constitutional and other difficulties nothing was was done till 1870. On December 14, 1870, was issued the famous resolution

of Lord Mayo in which the scheme by which the Government of India proposed to enlarge the powers and responsibility of the Provincial Governments in respect to public expenditure was explained. Services like jails, police, education and medical were transferred to the administrative control of the Governments of the Provinces, and to meet their cost were assigned to them departmental receipts under those heads and fixed lump grants from central revenues. The primary object of decentralization was relief to Imperial finances. The amount of the fixed grant for the transferred services was Rs. 4,68,87,110, or about seven per cent less for the whole of India than the assignments that had been made for these purposes in the last year of the old system. The Provincial Governments were expected to find funds for development by the re-distribution of expenditure on different departments and by local taxation. The measure was also expected to yield beneficial results in other ways. It was hoped that conflicts of opinion on account of the ill-defined character of the division of responsibility would be avoided, and that the new system would produce care and economy in public expenditure, import an element of certainty into the fiscal system, and lead to greater harmony in feeling and action between the Central and Provincial Governments. It was also anticipated that the operation of the scheme 'in its full meaning and integrity would afford opportunities for the development of self-government, for strengthening municipal institutions and for the association of Natives and Europeans to a greater extent than heretofore in the administration of affairs'. The change from annual assignments for each department in the Provinces to fixed assignments for the transferred services could not possibly have led to all these important results, and allowance has to be made for the fact that the authors of every measure of reform are apt to magnify the anticipated benefits of their plans; but this measure did effect a wide change in Indian administration, and was an important step in financial decentralization.

There is, however, another aspect of the measure which calls for special consideration on account of its important effect on later developments. The settlement

of 1871 was based on the actual expenditure of 1870–71. The expenditure of that year was, on account of the defects of the old system, very unequally distributed. Mr. Gokhale, in his evidence before the Welby Commission in 1897, drew the attention of the Commission to this fact. He said: 'The fact is that these inequalities are a legacy from the pre-decentralization period, when the expenditure of different Provinces was determined, not by the resources or requirements of those Provinces, but by the attention that their Governments succeeded in securing from the Central Government, i.e. by the clamour that they made. And when the first step was taken in 1870 in the matter of decentralization, the level of expenditure that had been reached in different provinces was taken as the basis on which the contracts were made, and the inequalities that then existed were, so to say, stereotyped. I think that it is high time that an effort should be made gradually to rectify these inequalities'.[1] Nothing was done to rectify these inequalities in 1897, and nothing has been done since to achieve this highly desirable object. It is necessary to appreciate the relative position of the different Provinces in this respect. The figures of the assignments per 1,000 of population of the different Provinces for the transferred services will give an idea of these inequalities.[2] Assam in that year was a part of Bengal and is, therefore, not separately shown. Burma was and is still a very thinly populated Province with an extensive area, and its figures are on that account not comparable with the figures of the other Provinces.[3] Bombay was 'easy first' and its expenditure on the transferred services was more than double that of Madras and the United Provinces, and nearly treble that of Bengal. The Central Provinces and the

[1] *The Welby Commission Report*, vol. I, p. 217, Q. 18094.

[2] Table II.

[3] Nothing will be said about Burma in the comments on successive settlements, as its position was peculiar. Upper Burma was not annexed till 1886, and even then it remained a charge on central revenues for many years. But it will be seen that, judged by figures of revenue and expenditure, its comparative position was and is not unsatisfactory.

Punjab were also far below Bombay in respect of expenditure.

The figures of expenditure on six heads, which are the most important from the standpoint of Provincial administration, are given for 1876–1877,[1] and show the level of expenditure reached in the different Provinces during the period of increasing financial decentralization. The figures of 1876–77 speak for themselves, and clearly show how, taking everything into account, Bombay and Bengal maintained the first and last position in the scale of expenditure.[2] The expenditure on district administration in Bombay was more than double that of the Punjab, the United Provinces, Assam and Madras, and was more than eight times that of Bengal. The expenditure of Bombay on general administration again was double that of the Central Provinces, Madras, the United Provinces and Assam, and about four times that of Bengal. The expenditure on law and justice did not vary quite to the same extent, but still the Bombay expenditure was far in excess of the expenditure in Bengal, and though the United Provinces was at the bottom of the scale, the position of the Central Provinces and Bengal was only slightly better than that of the United Provinces. The expenditure on police was again the lowest in Bengal; in other provinces it was more than double that of Bengal, and the Bombay index number is 365 as compared with 100 for Bengal.

The expenditure on education and medical services also shows striking inequalities which, on account of their intimate connexion with the well-being of the people, are even more damaging. In education Madras, the United Provinces, Assam and Bengal were on about the same level, though Bengal stood lowest. In Bombay the expenditure on education was about treble the expenditure

[1] The year 1876–77 has been selected as the starting point as it just preceded the year in which these services were provincialized, and also on account of changes of classification. The figures of years before 1875–76, as admitted by Mr. Jacob in his evidence before the Welby Commission, do not admit of a fair comparison with those of the subsequent years.

[2] Table III.

## TABLE III(a)

Statement showing expenditure in the different Provinces on certain selected services in 1876–77 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 854 | 374 | 232 | 365 | 325 | 285 |
| Central Provinces ... | 435 | 185 | 99 | 279 | 197 | 142 |
| Madras ... ... | 420 | 159 | 120 | 255 | 112 | 139 |
| Punjab ... ... | 309 | 244 | 122 | 215 | 145 | 135 |
| United Provinces ... | 350 | 140 | 87 | 208 | 110 | 78 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 412 | 159 | 168 | 213 | 117 | 82 |
| Burma ... ... | 827 | 470 | 425 | 662 | 295 | 260 |

in these Provinces. The Punjab and the Central Provinces, though not anywhere near Bombay, were well-off compared to the other four Provinces. In medical services Bengal, Assam and the United Provinces were badly provided. The expenditure in the Central Provinces, the Punjab and Madras was a little less than double that of the United Provinces and a little less that half that of Bombay. The expenditure in Bengal was a little more than one-third that of Bombay. These were the inequalities which, as Mr. Gokhale pointed out, were stereotyped when the first step was taken in decentralization in 1871. The attempt to carry on the financial administration of a country like India from one centre not only involved friction between the Government of India and the Provinces, but made it possible for some Provinces to go ahead at the expense of others. Bengal was the Province which came under British rule first, and still, compared to the other Provinces, it did not make much progress so far as its expenditure on vital services was concerned; and Bombay, for reasons which it is not easy to understand, reached a standard of expenditure far above the Indian average or the standard of any other Province. As will be shown later, it not only continued to retain this pre-eminent position till the inauguration of the Reforms, but has also occupied a position of differential advantage since then, and is still far above the other Provinces in respect of its standard of expenditure. The foundations of this disparity were laid in the pre-decentralization years. These figures, which are only approximately correct, are illustrative of the order of things under 'which the most violent had the advantage with very little attention to reason'.

The next step in decentralization was taken in 1877. Sir John Strachey in his financial statement of 1877–78 expressed his entire satisfaction with the system introduced in 1871, both on its financial and administrative side, and announced that the Government intended to carry it further. It was believed that the Provincial Governments, under the scheme of 1871, had no incentive to develop the revenues raised through their agency; and the services in which they were given a financial interest

were relatively few. The Government of India decided to transfer to the Provinces other services like land revenue, general administration, law and justice and excise, and at the same time gave them the revenues raised from law and justice, excise, stamps and licence (income) tax. The departmental receipts from the services committed to their charge were, of course, assigned to the Provinces, but as the anticipated yield of the revenue heads and departmental receipts was not sufficient for defraying the cost of the transferred services, the Provincial resources were supplemented by giving to each Province an adjusting assignment, the amount of which was fixed by taking into account the normal yield of assigned revenues and their normal rate of growth. Any increase over the revenues as they stood at the time of settlement was to be shared with the Government of India, who were also to bear a share of any decrease. Burma and Assam, with whom settlements were made in 1879 did not receive fixed assignments. They were given instead a share of the land revenue, a departure which was more in line with the changes introduced at the next settlement. Madras kept out of the new settlement, and continued to receive its revenues under the system introduced in 1871.

The expenditure of the different Provinces on the selected heads is given in Table IV. As the difference between the figures of 1876–77 and 1877–78 is inconsiderable, it is not necessary to comment again upon the relative position of the Provinces. A comparison of the two index numbers will show that the position was practically unchanged and the expenditure on these services covers the same range of variations. In 1877–78 all these subjects were provincialized, and, therefore, the responsibility for their development was entirely thrown on the Governments of the Provinces. The reforms of 1871 and 1877 were, in the words of Sir Richard Temple, expected to 'cause a more complete understanding to arise between the executive authorities and the tax-paying classes respecting the development of the fiscal resources'. For this understanding, however, is required an atmosphere of confidence which

## TABLE IV(*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1877–78 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 863 | 418 | 254 | 375 | 311 | 300 |
| Central Provinces ... | 426 | 222 | 97 | 272 | 183 | 135 |
| Madras ... ... | 424 | 152 | 115 | 165 | 107 | 157 |
| Punjab ... ... | 295 | 238 | 128 | 205 | 142 | 132 |
| United Provinces ... | 338 | 129 | 100 | 193 | 100 | 78 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 410 | 159 | 109 | 208 | 109 | 85 |
| Burma ... ... | 781 | 418 | 331 | 836 | 269 | 300 |

has been all along and is still lacking in India. But even if the conditions had been more favourable for the development of the fiscal resources of the Provinces, it would not have been possible for the Provincial Government, whose administration was in an undeveloped condition, to command the necessary resources for accelerating the rate of progress. As a matter of fact, the adjusting assignments were based on the appropriations of 1876–77, and the consolidated net grant was in most cases decreased. The system of decentralization was welcomed by the Provinces, because friction with the Central Government was thereby obviated and much useless correspondence avoided. But it did not give adequate resources to the Provinces nor provide conditions for the progressive administration of the services transferred to them. The only consideration which really weighed with the Government of India was that of administrative convenience. Sir Richard Temple in his speech on the scheme of 1870 dwelt at length on the advantages of his proposals, but added: 'The hopes which I am expressing, however sanguinely or confidently entertained, are after all but hopes, and like all other hopes may or may not be fully realized. But let all this eventuate as it may, sure I am, with certainty free from the shade of doubt, that the measure is advantageous to the Imperial budget of British India. For it will have the direct effect of definitely limiting, for the present, the expenditure from the general exchequer on certain important branches of civil expenditure, the very branches indeed, where, in the progressive state of the age, the demands for the increased outlets have arisen'. The other hopes which were so confidently entertained were, so far as they affected the welfare of the people, not realized, but the expenditure on subjects, for which additional expenditure was necessary, was definitely limited. It actually decreased after the inauguration of the system; and the expenditure on the provincialized services, as Lord George Hamilton admitted in his speech in the House of Commons on June 21, 1877, which had amounted to £6·03 millions in 1868–69, was reduced to £5·3 millions in 1877. As measures of economy and

harmony the reforms of 1871 and those also of 1877 were a great success, but otherwise they left the Provinces to stew in their own juice, and the problem of the resultant inequalities did not receive even a passing consideration at the hands of the Government of India. The position at the end of this period, i.e. in 1881–82, was about the same except that the expenditure on the provincial services was definitely lower than in 1877–78. The relative position of the Provinces remained the same.[1]

The settlement of 1877 remained in operation till 1882 when the system, that had been applied to Burma and Assam in 1879, was extended to the whole of India. The practice of assigning fixed permanent grants to the Provincial Governments was definitely abandoned, and instead they were granted the whole product of some sources of revenue and a share in the product of others. Receipts from forests, excise, licence (now income) tax, stamps and registration were divided between the Government of India and the Provinces. But as the revenue from these heads and the departmental receipts, which were, of course, provincialized, was not sufficient to meet the outlay devolving upon the Provincial Governments, the excess of Provincial expenditure was made up by assignments from the Central Government expressed as percentages of the land revenue in each Province. The expenditure on land revenue, general administration, law and justice, police, education and medical services was, with some minor exceptions, wholly provincial, and the distribution of expenditure on forests, excise, licence-tax, stamps and registration followed the incidence of revenue. Till then the revenue and expenditure had been classified either as Imperial or Provincial. To these two categories was added another in 1882—viz. divided heads, which remained till the introduction of the Reforms the most significant and characteristic feature of the system of Provincial finance. To the institution of this system were attributed later on all the complications of the pre-Reforms finance. But at that time it was introduced to secure financial

[1] Tables IV and IV (*a*), V and V (*a*).

TABLE V(a)

Statement showing expenditure in the different Provinces on certain selected services in 1881-82 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 782 | 355 | 222 | 398 | 326 | 371 |
| Central Provinces ... | 353 | 188 | 90 | 270 | 165 | 171 |
| Madras ... ... | 491 | 159 | 111 | 214 | 131 | 219 |
| Punjab ... ... | 263 | 237 | 125 | 242 | 139 | 185 |
| United Provinces ... | 317 | 122 | 86 | 221 | 87 | 100 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 365 | 162 | 88 | 300 | 110 | 109 |
| Burma ... ... | 1,102 | 414 | 301 | 827 | 209 | 280 |

stability for the Provinces by broadening the basis of their revenues, and to bring the financial interests of the Central and Provincial Governments as nearly as possible into unison with each other. The fact that the Government of India not only shared the receipts of, but also the expenditure on, certain heads was supposed to make them partners not only in their revenues but also in their cost; and further it was calculated to make them, to quote from the *Report* of the Decentralization Commission, 'more interested in and identified with local development.' The system of divided heads remained the most important feature of the Provincial settlements till the inauguration of the Reforms.

Another important feature of the financial settlement of 1882 was that it was made on a quinquennial basis. The settlement of Lord Mayo was subject to revision every year, and it lasted till 1877 by the process of constant renewals. The settlements were not made on a uniform basis. In 1882 the settlements with all the Provinces were revised at one and the same time, and were made for five years. The Government of India declared that they would make no demand on Provincial revenues, except in the case of a disaster so abnormal as to necessitate a suspension of the entire machinery of improvement throughout the Empire.[1] The object of quinquennial settlements was to ensure a greater continuity of financial policy; but, as will be pointed cut a little later, the periodical revisions caused a great deal of friction and irritation, and involved a protracted and controversial discussion with the Provincial Governments.

The figures of total revenue and expenditure of the Provinces and of expenditure on the selected heads for the year 1882–83 will give an idea of the comparative financial position of the different Provinces.[2] If we leave out Burma on account of its special circumstances, we find that Bombay was far above other Provinces in respect of both revenue and expenditure. The revenue and expenditure of all were the other Provinces per 1,000 of

[1] The G.O.I. Resolution No. 3352, dated September 30, 1881.
[2] Table VI, VII and VII (*a*).

## TABLE VII(a)

Statement showing expenditure in the different Provinces on certain selected services in 1882–83 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 766 | 353 | 215 | 401 | 326 | 390 |
| Central Provinces ... | 312 | 182 | 87 | 262 | 153 | 170 |
| Madras ... ... | 472 | 160 | 109 | 190 | 128 | 240 |
| Punjab ... ... | 250 | 235 | 122 | 224 | 128 | 200 |
| United Provinces ... | 310 | 117 | 85 | 204 | 84 | 120 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 378 | 167 | 92 | 254 | 113 | 120 |
| Burma ... ... | 1,150 | 425 | 302 | 896 | 193 | 250 |

population less than one-half of those of Bombay, and of Bengal was less than one-third. There was some increase in 1886–87 in the revenue and expenditure of practically all the Provinces; but Bombay increased its expenditure per 1,000 of population by 396, the Central Provinces by 160, Madras by 109, the Punjab by 80 and the United Provinces by 45, while the expenditure of Assam and Bengal was actually less in 1886–87 than in 1882–83.

The figures of expenditure on the Provincial services in 1882–83 and 1886–87 will show the relative position of the different Provinces during this period.[1] Burma may again be omitted, and, if we take the figures of expenditure in 1882–83, we find that, with Bengal as the base, the index number of Bombay for district administration was 766, for general administration 353, for law and justice 215, for police 401, for education 326, and for medical services 390. The Madras expenditure on district administration was about five times the Bengal expenditure for the same purpose, and the Central Provinces and the United Provinces spent about three times as much as Bengal on this head. The Punjab expenditure on general administration was higher than that of all other Provinces except Bombay. In respect of expenditure on law and justice, Bengal compared fairly well with the other Provinces though even on this head it spent less than half as much as Bombay, but in police expenditure again there were striking inequalities. The index number of Bombay is 401, of the Central Provinces 262, of Assam 254, of the Punjab 224, of the United Provinces 204 and of Madras 190, Bengal of course being 100. The difference in expenditure on education among Provinces other than Bombay were not very wide, though the latter spent twice as much as any other Province of India. The United Provinces spent less even than Bengal on education, while the Punjab, Madras and Assam spent a little more, and the Central Provinces expenditure on education exceeded that of Bengal by 53 per cent. In medical services again the

[1] Tables VII, VII (*a*), VIII, VIII (*a*).

TABLE VIII (e)

Statement showing expenditure in the different Provinces on certain selected services in 1886--1887 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 761 | 355 | 205 | 429 | 346 | 400 |
| Central Provinces ... | 430 | 193 | 89 | 246 | 158 | 166 |
| Madras ... ... | 482 | 155 | 109 | 178 | 128 | 252 |
| Punjab ... ... | 338 | 227 | 130 | 246 | 146 | 204 |
| United Provinces ... | 342 | 124 | 81 | 198 | 78 | 119 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 375 | 162 | 88 | 274 | 130 | 171 |
| Burma ... ... | 1,257 | 724 | 438 | 2,478 | 266 | 385 |

Bombay expenditure was more than double that of the other Provinces except Madras and the Punjab whose index numbers are 240 and 200 respectively.[1] The figures for 1886–87 show that the ratios between the expenditure of Bombay and Bengal on district administration, general administration, law and justice, were practically the same as those for the year 1882–83; while the ratios of expenditure on police, education and medical services changed in favour of Bombay.[2] In other respects the position did not undergo any considerable change, except that the Central Provinces and the Punjab spent more on district administration and that Assam raised appreciably its standard of expenditure on police, education and medical services. The United Provinces and Bengal, whose expenditure on education and medical services was the lowest in 1882–83, did not make any progress worth the name, while on medical services, Bombay continued to spend twice as much as any other Province of India except that Madras maintained its position in this respect though it was not much nearer Bombay in 1886-87 than it was in 1882–83. The total Provincial revenue increased from Rs. 16·8 crores in 1882–83 to Rs. 18·2 crores in 1886–87, while the average for this quinquennium was Rs. 17·35 crores It was not possible for any Province to make more liberal provision for its needs on account of the inadequacy of its resources; and the increase of expenditure, whatever it was, did not in any way rectify the inequalities of 1870–71 and 1877–78. Bombay increased its expenditure and improved its relative position in certain respects. The backward Provinces remained backward, while the more advanced ones were slightly better off at the end of this period. There was no attempt to temper the wind to the shorn lamb.

The first revision of the quinquennial settlement took place in 1887. In 1886 a special Finance Committee was appointed to consider Provincial finance, and to advise the Finance Department in carrying out this revision. This Committee was presided over by Sir Charles Elliot,

[1] Tables VIII and VIII (*a*).
[2] Table VII (*a*).

and three other members of the Committee were Sir W. W. Hunter, Mr. Justice Cunningham and Mr. Justice Ranade. This Committee submitted a proposal for the abolition of the divided heads, and the introduction of the system of Provincial contributions. This scheme was not seriously considered, and the Government of India proceeded to exercise the right, which they had expressly reserved to themselves, of revising the settlement to their own advantage. It was estimated that, on the old basis, the revenue of the Provincial Governments would be in excess of the expenditure by Rs. 65,52,000. This surplus the Government of India took from the Provincial Governments and added to their own resources. The amount of this resumed surplus was distributed among the Provinces as follows:—The United Provinces Rs. 10,31,000, the Central Provinces Rs. 1,56,000, Bombay Rs. 22,19,000, Madras Rs. 17,44,000, Bengal Rs. 11,56,000, Assam Rs. 2,46,000. Five out of eight Provinces were left with revenues which were estimated to be just equal for the time being to the liabilities that had to be met from them, and it was expected that the growth of expenditure would be provided for by the growth of revenues. But the net result of the revision was that the expenditure in 1887–88 on Provincial services had to be reduced on account of the resumption of surpluses.[1]

We can get a definite idea of the effect of the new settlement on Provincial expenditure by examining the figures.[2] The figures of the total Provincial revenue and expenditure for 1887–88 and 1891–92—the first and the last years of the five years' period—are also given.[3] As Burma need not be taken into account, the position of Bombay, in respect both of revenue and expenditure, was what it had been in the preceding period. The revenues of Bombay were more than those of any other two Provinces taken together, and its expenditure in proportion to its population was correspondingly high. In 1887–88 both the revenue and expenditure of Bengal were the

[1] Tables VI and IX.
[2] Tables X and X (a), XI and XI (a).
[3] Table IX.

TABLE X (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1887–88 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 759 | 348 | 261 | 401 | 322 | 390 |
| Central Provinces ... | 456 | 190 | 88 | 237 | 151 | 165 |
| Madras ... ... | 498 | 153 | 109 | 171 | 118 | 245 |
| Punjab ... ... | 345 | 216 | 134 | 247 | 118 | 186 |
| United Provinces ... | 350 | 119 | 83 | 197 | 74 | 109 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 378 | 170 | 87 | 275 | 125 | 168 |
| Burma ... ... | 1,494 | 889 | 298 | 610 | 234 | 547 |

lowest; and the Punjab and Madras were nearly in the same position. The United Provinces were 'assigned revenues which, though higher than those of Bengal, gave them very limited resources, and their standard of expenditure was lower than that of all other Provinces except Bengal. In 1891–92 the United Provinces was the only Province whose expenditure was actually lower than that of 1887–88. In the last year of this period there was a tendency to increase expenditure in order to get more favourable terms in the next Provincial contract, and the total Provincial expenditure in 1891–92 was Rs. 20·45 crores as compared with Rs. 18·36 crores in 1890–91[1], and the standard of expenditure in that year was considerably higher than that of 1887–88. The increase of expenditure in 1891–92 was unduly large on account of the stimulus given to it by the prospect of revision, and the average for this period was Rs. 18·31 crores as compared with Rs. 20·45 crores in 1891–92. This fact has, therefore, to be allowed for in the interpretation of these figures.

Table X gives figures of expenditure on the main Provincialized services for 1887–88. They do not differ materially from those of 1886–87 though on account of the reduction of Provincial revenues, the expenditure on various heads was somewhat lower than that of the preceding year. The revenue and expenditure of the Provinces increased during the following years, and in 1891–92 the expenditure was, as already stated, considerably higher than that of 1887–88. The decrease shown in Table XI is due to the fact that the averages have been worked out on the basis of the population of the 1891 census, which in all cases was much larger than that of 18 1. The population of India in 1891, according to the 1891 census, was 287 millions as compared with 253 millions in 1881. The index numbers of expenditure of the different Provinces in 1891–92 given in Table XI (*a*) show their relative positions at the end of this period. A comparison with similar tables for the previous year shows t at the standard of expenditure in Bengal was

[1] *The Welby Commission Report*, vol. I, Appendices, p. 48.

## TABLE XI (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1891–92 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 614 | 315 | 180 | 341 | 329 | 337 |
| Central Provinces ... | 385 | 171 | 55 | 185 | 135 | 143 |
| Madras ... ... | 442 | 145 | 100 | 137 | 133 | 297 |
| Punjab ... ... | 353 | 210 | 136 | 224 | 136 | 269 |
| United Provinces ... | 259 | 108 | 88 | 164 | 78 | 106 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 301 | 146 | 67 | 267 | 117 | 204 |
| Burma ... ... | 926 | 446 | 282 | 1,484 | 133 | 221 |

raised during this period, while that of the United Provinces remained practically stationary. On district administration Bombay spent more than twice as much as Assam and the United Provinces, and though the Central Provinces and the Punjab were nearly equal, the expenditure of Madras on this head was much higher than that of all other Provinces except Bombay. On general administration the Bombay expenditure was more than double that of Madras, the United Provinces and Assam and more than fifty per cent higher than that of the Central Provinces and the Punjab. The expenditure of Madras on police was less than half that of Bombay, while the difference between the expenditure of the latter and that of the other Provinces, though not as wide as on the other three heads, was still not inconsiderable. On education the United Provinces expenditure was again the lowest, and the expenditure of Bombay was more than double that of any other Province. Madras increased its expenditure on education and spent nearly as much per 1,000 of population as the Punjab and Central Provinces, while the United Provinces and Bengal also increased their expenditure, but Assam did not make any progress in this direction. The medical expenditure of the United Provinces and the Central Provinces was low; the Punjab, Madras and Assam were fairly well off, and Bombay, of course, was ahead of the other Provinces. The expenditure of Bengal on district administration, in spite of improvement in its position, was less than one-sixth that of Bombay; and on all other heads, except law and justice, less than one-third, and on law and justice a little more than one-half. This period was not as unsatisfactory as the preceding one on account of the fact that Bengal made up the leeway to a certain extent, but the progress was accidental and not the result of any attempt to remedy the evil of inequalities. No readjustment was made on this account during the period, and its necessity was not at all recognized by the Government of India.

The Provincial contracts were due for revision again in 1892. The framework of the settlement was not changed. The heads, which were Imperial and Provincial,

remained Imperial and Provincial in this quinquennium, and the divided heads continued to be jointly shared by the Central and Provincial Governments. But the Government of India once more revised the settlement to their own advantage, and made the position of the Provinces worse and their own better by a net sum of Rs. 46,63,000. This amount was distributed among the Provinces as follows:—Bombay 13,11,000, Central Provinces 2,27,000, Punjab 4,10,000, Madras 10,38,000, the United Provinces 5,69,000, Bengal 5,19,000, Burma 5,89,000. But it was found necessary to provide adjusting assignments under land revenue to establish equilibrium between Provincial revenues and expenditure. This again introduced an element of rigidity in Provincial finances, and it was not possible for the income of the Provinces to keep pace with their growing expenditure.

The system of resumption of Provincial surpluses was the cause of acrimonious controversy between the Central and Provincial Governments. Sir H. Waterfield, the Finance Secretary, India Office, thus described the nature and objects of these revisions : 'The object is, on the one hand, to ensure to the Imperial Government a due share of the improvement that has taken place in the revenue from the development of the country ; and on the other hand, while giving the Provincial Governments a fair proportion of the increase to lessen the chance of their being called upon to render abnormal assistance to the Imperial Government.'[1] It has already been pointed out that the Government of India took more than their due share of the improvement that had taken place in the public revenues, and rendered it necessary for the Provinces to reduce their expenditure after the revisions of 1887 and 1892. But another result of these periodical revisions, was that they tended to encourage extravagance rather than economy, and introduced an element of fiscal uncertainty in Provincial finances, the removal of which was considered one of the most important objects of the scheme of 1882. The system came in for a great deal of adverse

[1] *The Welby Commission Report*, vol. III, p. 26, Q. 588.

criticism at the hands of the Provincial Governments. Sir A. Mackenzie, the Lieutenant-Governor of Bengal, considered it his duty to condemn it publicly in his speech in the supreme Legislative Council in 1896. He said, 'I deprecate the way in which these quinquennial revisions have too frequently been carried out. The Provincial sheep is summarily thrown on its back, close clipped and shorn of its wool and turned out to shiver till its fleece grows again.' The 'shearing' of the Provincial sheep had an extremely demoralizing effect on the administration of Provincial finances. Its effect was described by Sir A. Mackenzie in the following words :—'The normal history is this : two years of screwing and saving and postponement of works, two years of resumed energy on a normal scale, and one year of dissipation of balances in the fear that, if not spent, they will be annexed by the supreme Government at the time of the revision.' Economy was not considered an economic virtue as it was known that, if a Province practised it, its reduced standard of expenditure would be the basis for a correspondingly unfavourable settlement at the next revision. The Provinces, in order to avoid this consequence, increased their expenditure, depleted their balances and assumed an appearance of financial stringency just before the expiry of the quinquennial period. In these circumstances it was inevitable that economy in expenditure should come to be regarded by the Provinces as a despised quality, and a premium put on unnecessary and even wasteful expenditure. Sir James Westland, the Finance Member of the Government of India, in his speech delivered in the Legislative Council on March 27, 1897, in the course of the discussion on the Financial Statement of 1897–98, put forward a number of reasons in favour of the periodical revision of the Provincial contracts. Among others there was one on which he laid very great stress, and that was that, without the resumption of surplus Provincial revenues, it would not be possible for the Government of India to satisfy the claims of the tax-payers and remit taxation. 'It is this necessity (of remission of taxation),' he said, 'an absolute necessity of a sound financial system—which gives

rise to the periodical revision of Provincial contracts.'[1] The resumption of revenue surpluses in 1887 and in 1892 was necessitated by the financial position of the Government of India, and was not followed by any remission of taxation. The real reason why the Government of India did not want to foster the belief that the Provinces had a permanent claim on any portion of the Indian revenues was that, having assumed all the risks of Indian finance—risks of war, famine, opium revenue and exchange—they wanted to retain their hold on the entire tax system, and assert their right to re-distribute public revenues to their own advantage at the end of the quinquennial period. The constitutional position of the Government of India being what it was, it was not possible for them to alienate any portion of their revenues permanently; but the practice of resuming Provincial revenues had a very undesirable effect on the integrity of the whole fiscal system, and accentuated the arbitrary character of the financial settlements with the Provinces.

The figures of revenue and expenditure for 1892–93 and 1896–97[2]—the first and the last years of this quinquennium—may now be analysed. The fact that their expenditure per 1,000 of population in 1892 was lower than in 1887 was due to the increase of population and not to any decrease of their resources. It would appear that all the Provinces were on the same footing,[3] inasmuch as they received revenues just sufficient to make both ends meet, but otherwise there was no change in their positions in the scale of expenditure, except the United Provinces and the Central Provinces changed places, the latter getting the better of the former. The revenues and expenditure of Bengal, though still the lowest in the whole of India, were a little less inadequate than before. In 1896–97 Bengal improved its position still further, but the United Provinces did not make any headway. Madras and Assam were distinctly better off at the end of this period; and in the Punjab, the expansion

[1] *The Welby Commission Report*, vol. I, Appendix 84, p. 371.
[2] Tables XII, XIII and XIII(*a*), XIV and XIV(*a*).
[3] Table XII.

## TABLE XIII (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1892–93 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 560 | 307 | 177 | 324 | 333 | 350 |
| Central Provinces ... | 361 | 192 | 64 | 197 | 140 | 152 |
| Madras ... ... | 305 | 221 | 139 | 235 | 143 | 275 |
| Punjab ... ... | 404 | 139 | 103 | 137 | 145 | 291 |
| United Provinces ... | 247 | 107 | 87 | 142 | 84 | 110 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 249 | 174 | 66 | 240 | 123 | 205 |
| Burma ... ... | 890 | 454 | 280 | 1,397 | 142 | 116 |

of resources and expenditure, though not as great, was not inconsiderable. The index numbers of expenditure of the different Provinces show their relative positions.[1] The scale of expenditure of Bombay in 1896–97 did not compare as favourably with that of Bengal as it did in 1892–93 and the preceding years, but even in 1896–97 its position was not unenviable. The expenditure on general administration was increased in all the Provinces except Madras and the United Provinces, where, however, the standard was practically the same. In respect of law and justice, Bombay was far above the other Provinces; and its expenditure was about treble that of the Central Provinces and Assam, and was considerably higher than that of the Punjab, Madras and the United Provinces. In expenditure on education all the Provinces were much worse off than Bombay, and each of them spent less than one-half of the latter. The United Provinces once again was at the bottom of the scale. On medical services also Bombay spent more than twice as much as the United Provinces and the Central Provinces. Madras and the Punjab were fairly high in the scale, but the expenditure of Assam on this head was little more than half that of Bombay. In 1896–97 the general standard of Provincial expenditure was appreciably raised, but there was no substantial change in the relative financial positions of the Provinces. The expenditure per 1,000 of population showed the same range of variations, and the standing of the different Provinces in respect of expenditure on various heads was practically the same. This period was favourable for the Provinces taken collectively; and though one or two Provinces even improved their relative positions, there was not any really material change in the situation.

This result was due to the fact that the inequalities which were crystallized in the standards adopted in 1871 and 1877 continued to affect the financial settlements in later years. Sir Charles Elliot, the President of the Finance Committee of 1886, giving evidence before the Welby Commission in 1897, stated this fact in the

[1] Tables XIII(*a*) and XIV(*a*).

## TABLE XIV'(a)

Statement showing expenditure in the different Provinces on certain selected services in 1896–97 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 487 | 319 | 170 | 353 | 332 | 275 |
| Central Provinces ... | 319 | 212 | 63 | 201 | 140 | 114 |
| Punjab ... ... | 271 | 219 | 143 | 239 | 130 | 291 |
| Madras ... ... | 375 | 139 | 98 | 141 | 143 | 217 |
| United Provinces ... | 226 | 107 | 97 | 169 | 85 | 77 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 243 | 200 | 66 | 289 | 133 | 169 |
| Burma ... ... | 767 | 485 | 306 | 1,268 | 169 | 192 |

following words :— 'No attempt has ever been made to compare the wants of one Province with another on a theoretical basis, and to establish them all on a common footing of financial prosperity. In each contract the existing status has been taken as a starting point, and some addition, greater or smaller, has been made to their existing income or expenditure.'[1] The Government of India did not make any effort to establish them all on a common footing on account of the difficulty of making an equitable re-adjustment. Mr. Stephen Jacob, Comptroller and Auditor-General, India Office, explaining the nature of this difficulty to the Welby Commission, said, 'It is an undoubted fact that the original allotments were made on the basis of existing facts. The plan adopted by the Government of India was not that of setting up a theoretical standard of expenditure for all Provinces, and endeavouring to introduce it suddenly and at once. Any such changes must be introduced gradually and the Government recognized this. But it was one of the main objects of the decentralization scheme to get rid of the haphazard allotment of resources in the future, and starting, as they must, from the existing state of things, to introduce a plan under which the Local Governments would be able gradually to develop their resources and to expand their expenditure on useful objects. If the Local Governments are at each revision to press their claims to consideration of what they deem the requirements of their Provinces, and to demand additional resources to meet those requirements, the so-called allotment by clamour would continue in force.' [2] The fact that the contract system was engrafted on the previous system made it difficult for the Government of India to set up a theoretical standard of distribution of revenues, but it should have been possible for them to introduce a greater degree of financial alignment in 1896–97 than was actually the case In 1856–57 the total expenditure on education in Bengal was Rs. 9·48 lacs, in Bombay Rs. 8·52 and in Madras 3·42 lacs. In 1876–77 the

[1] *The Welby Commission Report*, vol. I, Appendix 88, p. 411.
[2] Ibid., p. 324, Q. 20052

expenditure for the same purpose in Bengal was Rs. 40·77 per 1,000 of population, in Bombay Rs. 130·06 and in Madras Rs. 45·85. In 1896–97 the educational expenditure of the same Provinces per 1,000 of population was Rs. 55·23, Rs. 183·4 and 72·4 respectively. These inequalities were, therefore, practically created after 1856–57, and it should have been possible for the Government to undo a part of the mischief that had been done in twenty years of centralization by making more liberal provision for those Provinces which were comparatively undeveloped in 1876–77. The allotment by clamour was allotment without any fixed or intelligible principle; but if the Government of India had laid down the principle of raising all the Provinces to the same level of development and tried to realize it by gradual steps in the successive financial settlements, they could have acted on their own initiative without having the claims of the Provinces pressed on their attention by the Provincial Governments. This, of course, means that the Government of India should have taken what may be called a dynamic view of their own responsibilities, and considered themselves under an obligation to provide conditions for the development of the country as a whole. This obligation the Government of India have never assumed in the past, and they will only assume it when they are animated by a determined purpose to stimulate the nation to a much higher level of constructive activity. This sounds almost Utopian even now. In the two decades before 1896–97 the conditions were much more static than at present, and the Government of India were mainly concerned with keeping things going. The fault was in the system of administration and not in the Provincial contracts; but it was there, and the result was extremely unsatisfactory from every point of view.

The next revision took place in 1897. On this occasion the Government of India did not alter the settlements to the detriment of the Provinces, but the shares of the different Provinces of the divided heads were changed to obviate as far as possible the necessity of making fixed assignments. The figures of revenue and expenditure

for 1897–98 and 1906–07 may now be examined.[1] The year 1906–07 has been selected for comparison because the next financial settlement, though introduced in 1904–05, was not concluded till 1907. The figures of revenue and expenditure of Bengal and Assam are not given for 1906–07 on account of the territorial changes of 1905. The position in 1897–98 was the same as that in 1896–97 in respect of the total revenue and expenditure. In 1906–07 there was considerable expansion in the revenue and expenditure of all Provinces as compared with 1897–98. The Central Provinces revenue and expenditure per 1,000 of population in 1906–07 exceeded those of Madras and the Punjab, but otherwise there was no noteworthy change. There is the same monotony about the figures of expenditure of 1897–98 and 1906–07.[2] If we compare the Bombay and Bengal expenditures in 1897–98 and again in 1906–07, we find that the Bombay expenditure is relatively higher in 1897–98 than in 1896–97, and in 1906–07 still higher than in 1897–98. For 1906–07 the Bengal and Assam figures of 1904–05 have been used on account of the amalgamation of Assam with Eastern Bengal in 1905. The Central Provinces considerably improved its position during this period, and the United Provinces expenditure on education and medical services was increased; but as, for Bengal, the figures of 1904–05 have been taken, the comparison is slightly vitiated on that account. As between the different Provinces the expenditure in Bombay on district administration was more than double that of the United Provinces and Assam as was the case in 1896–97 and 1897–98; on general administration it was more than double that of the United Provinces and Madras, and in this respect again the position in 1906–07 was not very different from that in 1896–97 and 1897–98. The expenditure on law and justice in 1906–07 was low in Assam and the United Provinces as compared with that of Bengal and other Provinces, and the Central Provinces, Madras and the Punjab raised their level of expenditure on this head during the

[1] Tables XV, XVI and XVI (*a*), XVII and XVII (*a*).
[2] Tables XVI and XVII.

TABLE XVI

Statement showing expenditure in the different Provinces on certain selected services in 897–98 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 524 | 331 | 172 | 364 | 323 | 551 |
| Central Provinces ... | 356 | 225 | 656 | 192 | 140 | 121 |
| Madras ... ... | 407 | 140 | 99 | 136 | 143 | 211 |
| Punjab ... ... | 304 | 221 | 145 | 221 | 132 | 302 |
| United Provinces ... | 244 | 112 | 99 | 168 | 85 | 86 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 259 | 195 | 69 | 276 | 136 | 178 |
| Burma ... ... | 862 | 500 | 277 | 124 | 185 | 183 |

period. The police expenditure of the United Provinces and the Central Provinces shows a remarkable increase; while Madras, whose expenditure on police was, next to Bengal, the lowest in 1896–97 and 1897–98, occupied the same position in the scale in this respect in 1906-07. On education again the Bombay expenditure was more than double that of all other Provinces except the Central Provinces; and though the latter increased its expenditure on education from 1897–98 to 1906–07, it was still very much lower than that of Bombay. In 1897–98 the medical expenditure in certain Provinces was inflated owing to the measures taken by them against the outbreak of plague. The expenditure on this head in 1906–07 was particularly low in the Punjab and the United Provinces; and in Madras and Assam, though very much lower than that of Bombay, it compared favourably with that of the remaining Provinces.

During this period there was a great improvement in the finances of the Government of India on account of the stability of exchange and other favourable circumstances, and they were in a position to give grants-in-aid to the Provinces. These grants or 'doles', as they were opprobriously called, were generally given for specific purposes and were in some cases recurring. The total amount so distributed was considerable, and in Table XVIII are given the figures of the grants received by the different Provinces from 1897–98 to 1906-07. They are given per 10,000 of population for facility of comparison. The Government of India could easily have disregarded the established tradition in the distribution of their surpluses; but an analysis of these figures shows that they followed the policy of adding more to those who were already well off and there was no attempt to adjust these subsidies to the needs of the different Provinces. The amount received by Bengal per 10,000 of population was Rs. 233·33 and by the United Provinces Rs. 340·42 as compared with Rs. 2,542·10 by Bombay. These grants were given in a haphazard manner, and unfortunate Provinces like the United Provinces and Bengal received very little. The bias in favour of the Provinces which had a high standard of expenditure, was not made any

TABLE XVII (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1906–07 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... .. | 569 | 332 | 191 | 379 | 343 | 362 |
| Central Provinces ... | 401 | 241 | 103 | 260 | 191 | 167 |
| Madras ... ... | 414 | 129 | 100 | 155 | 143 | 243 |
| Punjab ... ... | 326 | 150 | 143 | 233 | 150 | 156 |
| United Provinces ... | 252 | 126 | 72 | 217 | 123 | 105 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 250 | 170 | 71 | 260 | 153 | 210 |
| Burma ... ... | 839 | 429 | 289 | 979 | 249 | 527 |

less pronounced by this lack of method in the distribution of grants.

In 1904 the financial settlements were made quasi-permanent with some of the Provinces, and by 1907 these settlements were concluded with all the Provinces. 'The object of making the Provincial settlements quasi-permanent,' as stated by Lord (then Mr.) Meston in his evidence before the Decentralization Commission, was 'to give the Local Governments a more independent position and a more substantial and enduring interest in the management of their resources than had previously been possible.'[1] Each Province was given, in the form of a defined share of revenues and fixed assignments, an income sufficient for its normal expenditure; and the Government aimed at making these assignments as small as possible in order that each Province might derive the bulk of its resources from growing revenues. The revenue assigned to the Provinces was definitely fixed, and they were spared the necessity of having recourse to what Sir Alexander Mackenzie called 'the tactics of the weak', and could husband their resources with an assurance that the Central Government would not deprive them of their unspent balances.

The comparative positions of the Provinces can be judged by the figures of revenue and expenditure for 1907-08 and 1911-12 and those of expenditure on the selected heads for the same years.[2] It is not necessary to offer any remarks on them as once more the comparative financial position of the Provinces was practically unchanged. The Bengal and Assam figures of expenditure on the selected services are the same as those in Table XVII, as the partition of Bengal was not annulled till 1912-13. The figures of the grants-in-aid distributed during this period are given in Table XVIII. Bengal and the United Provinces received better treatment during this period, and the grants to the Punjab were also increased. Madras did not fare well, and the amount

[1] *The Decentralization Commission Report*, vol. X, p. 123, Q. 444, 860.

[2] Tables XIX, XX, and XX(*a*), XXI and XXI(*a*).

## TABLE XX (a)

Statement showing expenditure in the different Provinces on certain selected services in 1907–1908 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 578 | 344 | 194 | 429 | 357 | 327 |
| Central Provinces ... | 426 | 238 | 109 | 285 | 200 | 175 |
| Madras ... ... | 436 | 132 | 101 | 171 | 165 | 156 |
| Punjab ... ... | 332 | 155 | 139 | 262 | 152 | 254 |
| United Provinces ... | 250 | 132 | 71 | 227 | 124 | 124 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 250 | 170 | 71 | 260 | 153 | 210 |
| Burma ... ... | 864 | 470 | 303 | 989 | 265 | 573 |

received by Bombay was again very high. Assam received handsome assistance, but subsidies to the Central Provinces were lower by comparison. Grants continued to be distributed during this period in spite of the protests of some Provincial Governments against their being used as an instrument of centralization. Their effect on the relative positious of the Provinces was to accentuate the inequalities of resources and expenditure.

The problem of the financial relations between the Central Government and the Provincial Governments was examined by the Decentralization Commission in 1907–09. The Commission approved of the underlying principles of the Provincial settlements, and did not recommend a more definite separation between Central and Provincial finances by the abolition of the divided heads of revenue and expenditure. They considered three alternative methods by which the Government of India could be placed in funds for meeting their expenditure, but found all of them unworkable ; and they were further of opinion that the system of divided heads had certain advantages of its own which rendered its continuance desirable on its own merits. They did not consider it practicable to prohibit the grant of fixed assignments, but recommended that, when they became unduly large in any Province, they should be commuted into a share of growing revenues. They also approved of the system of special grants, and were of opinion that these grants made it easier for the Government of India to call upon all the Provinces to take simultaneous steps towards the development of a particular service. In a word, they did not recommend any fundamental change in the Provincial settlements, though they considered that the grant to the Provincial Legislatures of more effective powers of control over the Provincial finances would render it desirable to give the Provinces more distinct sources of revenue and concomitantly more final powers over their budgets. The Commission did not consider the question of the rectification of inequalities, and, therefore, did not make any recommendations on this point.

## TABLE XXI (a)

Statement showing expenditure in the different Provinces on certain selected services in 1911–12, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 600 | 520 | 204 | 532 | 343 | 335 |
| Central Provinces ... | 391 | 258 | 138 | 242 | 160 | 189 |
| Madras ... ... | 433 | 155 | 108 | 205 | 148 | 116 |
| Punjab ... ... | 346 | 205 | 166 | 306 | 165 | 294 |
| United Provinces ... | 254 | 144 | 76 | 234 | 137 | 167 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 250 | 170 | 71 | 260 | 153 | 211 |
| Burma ... ... | 788 | 507 | 248 | 1,061 | 227 | 403 |

The quasi-permanent settlements were revised in 1910–11, and a reconsideration of the whole question was necessitated by the defects of the arrangements of 1904–07. The Government of India did not want to make any radical change in the system, for it was, in their opinion, 'preferable to abide by the main lines of the system which had gradually been built up to meet the needs of the country than to look about for an untried scheme of greater abstract perfection,'[1] but they considered it desirable to give greater permanency to the settlements, and remove the minor defects in them, preliminary to the introduction of the permanent arrangements. With this object they made a detailed review of the financial position of each Province, with direct reference to the outlay which it might reasonably claim to incur upon the services which it administered; and, as a result of this examination, it was found advisable to make variations in the terms of the settlements. The financial effect of this arrangement was to convert fixed assignments amounting to 350 lacs of rupees into a share of growing revenues, and to deprive the Central Government in future years of an annual net increment of 8·15 lacs in their share of the divided heads. The Government of India retained the option of declaring the purposes for which special grants might be provided out of the surplus revenues with an assurance, however, that these grants would not involve greater interference by the Central Government in the internal administration of the Provinces. The scheme was intended to mark an advance along the path of decentralization, and to place upon the Provincial Government a greater responsibility for the stability of their finances. These permanent settlements remained in force till the introduction of the Reforms.

The Government of India, in their Resolution referred to in the preceding paragraph, examined the charge that the settlements were of unequal liberality in the different Provinces. They admitted the difficulty of giving a conclusive reply to the arguments by which this charge

[1] The G. O. I. Resolution No. 27-F, dated 18 May 1912.

was supported, but were of opinion that the inequality of treatment, if it existed at all, was historical and inevitable rather than an outcome of administrative partiality and even maintained that its existence was extremely doubtful. They were of opinion that the influences that had been at work since 1882 had reacted on each successive revision of the Provincial settlement and had inevitably worked towards an equalization of the scale of expenditure in the different Provinces. 'The higgling of a quarter of a century had,' according to them, 'established a rough equity which could not now be replaced by theoretical calculation . . . Taking the administrative equipment as a whole, the Government of India found it impossible to believe that inequality in the settlements had gone far enough to starve one Province in its necessities in order to load another with luxuries.' No Province was loaded with luxuries, for even the most advanced Provinces could not satisfy adequately the elementary needs of progressive administration, but some Provinces were starved more than others of their necessities. That during the intervening years since 1882 this aspect of the Provincial settlements did not receive any consideration is the thesis which has been put forward in this chapter, and supported by the figures of the total revenue and expenditure and also of the expenditure on the more important Provincial services. Their argument was concluded by the Government of India with the statement that they considered it 'entirely unnecessary, in seeking a basis of permanency, to make any radical alterations in the existing settlements which had been evolved by a slow process of years'. 'By a slow process of years' had been evolved not only the settlements themselves but also the inequalities which were inherent in them; and the refusal of the Government of India to admit their existence—not to speak of rectifying them—accounts for the exceptional complexity of the problem of federal finance in India and the impossibility of establishing 'a basis of permanency'.

The figures of 1912–13 and 1920–21 may now be analysed to see whether 'rough equity', which certainly did not exist previously was established during this

period.[1] In 1912–13 Bengal was reconstituted, Assam was separated from Eastern Bengal, and Bihar and Orissa became a separate Province. The separation from Bengal of the latter, with its population of 34 millions, has a special significance of its own, for it changes the basis of comparison for later years, and shows that Bengal proper, though by no means a favoured Province, was not as low in the scale of expenditure as would appear from the figures of the preceding tables. It was the low scale of expenditure in the districts, now included in Bihar and Orissa, which gave Bengal the lowest position in respect of revenue and expenditure. Before 1912, this Province, as an outlying portion of the province of Bengal, did not receive its proper attention from the Provincial Government; and the result was that, when it was given its own administration, its scale of expenditure was much lower than that of Bengal proper. The revenue per 1,000 of population in Bihar and Orissa in 1912–13 was Rs. 971·5, as compared with Rs. 1,592·28 in Bengal; and the expenditure per 1,000 was Rs. 767·97 in Bihar and Orissa and Rs. 1,265·51 in Bengal. The expenditure on law and justice and education in Bihar and Orissa was one-half that of Bengal, on medical services less than two-fifths; and on district administration, general administration and police the difference between the expenditure of these Provinces was also considerable. This, of course, means that since 1861 Bihar and Orissa had suffered from continuous neglect, and in the successive financial settlements the needs of a Province, whose population is about one-seventh of the total population of British India, practically received no consideration whatsoever. The centralization of finances did this Province a double wrong. The revenues assigned to Bengal were utterly inadequate on account of the adoption of a low standard of expenditure for the Presidency; and Bihar and Orissa did not receive its proper share even of the limited income of Bengal on account of its being regarded merely as an adjunct to the latter. In 1912–13 the low scale of expenditure then

[1] Tables XXII, XXIII and XXIII (*a*), XXIV and XXIV (*a*).

## TABLE XXIII(a)

Statement showing expenditure in the different Provinces on certain selected services in 1912–13 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 401 | 268 | 143 | 236 | 210 | 217 |
| Central Provinces .. | 202 | 101 | 65 | 121 | 84 | 118 |
| Madras ... ... | 313 | 67 | 77 | 118 | 99 | 85 |
| Punjab ... ... | 285 | 131 | 118 | 132 | 150 | 236 |
| United Provinces ... | 169 | 75 | 51 | 127 | 74 | 109 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 183 | 167 | 66 | 178 | 89 | 157 |
| Burma ... ... | 530 | 189 | 210 | 595 | 122 | 321 |
| Bihar and Orissa ... | 89 | 65 | 51 | 61 | 51 | 38 |

existing in Bihar and Orissa was made the basis of the settlement with this Province. Even in the distribution of grants-in-aid from 1912–13 to 1918–19, this Province did not receive any adequate consideration; and its share per 10,000 of population was only Rs. 653·85, while Bengal received Rs. 1,323·07 and Assam Rs. 4,411·76.[1] The position of Bihar and Orissa is at present almost desperate. This, it must be remembered is, due to the history of its finances since 1861; and it is impossible to ignore this cardinal fact in the impending financial re-adjustments. A comparison of the position of Bengal with that of other Provinces in 1912–13 [2] brings out the same fact clearly. In 1911–12, if we adopt what is admittedly an unsatisfactory basis, viz. that of 1904–05, the Bengal expenditure was the lowest in India under practically all heads. The only exception was law and justice, in respect of which even in 1876–77, the initial disadvantage of Bengal was not as striking; and the expenditure on which was higher in 1911–12 than that in Assam and the United Provinces. In 1912–13 the expenditure of Bengal was higher than that of four Provinces on general administration, of five Provinces on law and justice, of five Provinces on education, and of three Provinces on medical services. This relative improvement in its position was due to the separation of Bihar and Orissa, which, as stated above, had been a depressing factor in the calculation of averages. But even if we make allowance for this fact, Bengal compared unfavourably with some other Provinces. The expenditure of Bombay on general administration, police, education and medical services was more than 100 per cent higher than that of Bengal, on district administration 400 per cent higher, and even on law and justice the Bombay standard was far above that of Bengal. Among other Provinces the disparity was just as remarkable. The Central Provinces expenditure was less than one-half of that of Bombay under all heads, and the level of expenditure in Madras was lower than that of the Central Provinces on all Provincial services except

[1] Table XVIII.
[2] Tables XXI and XXI (*a*), XXIII and XXIII (*a*).

district administration, education and law and justice. The United Provinces expenditure was about one-third of that of Bombay on all services except police and medical, the expenditure on the former being about one-half and on the latter a little over one-fifth of the Bombay expenditure. The expenditure of Bihar and Orissa was, of course, lower than that of all other Provinces. The only Province, whose standard of expenditure could not be taken as an ideal for Bihar and Orissa to work up to was the United Provinces; but even its expenditure on district administration and police was about double that of this unfortunate Province. The Punjab expenditure, though very much lower than that of Bombay, was higher than that of Madras, the United Provinces, the Central Provinces, Assam, and Bihar and Orissa; the only two heads under which its expenditure did not come up to their level were district administration and general administration. On the former Madras spent about 50 per cent more than the Punjab, and on the latter the Assam expenditure was in excess of that of the Punjab by about 25 per cent. These variations can, however, be explained by differences of local circumstances; and on the whole it may be said that, next to Bombay, the Punjab received what may be called the most-favoured-province treatment. The Government of India, in their Resolution of 1912, referred to above, said that one Province might be behind another in its jails, or a third in its roads, and its subordinate officials might be worse paid than in the fourth, but the higgling of a quarter of century had established a rough equity which they did not want to disturb. This statement must, in spite of its authoritative character, be treated as a disingenuous attempt on the part of the Government of India to deny facts which they could neither explain nor justify. There was no equity, rough or refined, in the settlement of 1911.

The figures of revenue and expenditure for 1920–21 show the cumulative effect of these inequalities just before the introduction of the Reforms and the new financial settlement. There was considerable expansion of Provincial expenditure after 1912–13, and all Provinces

## TABLE XXIV (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1920–21 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| Bombay ... ... | 511 | 206 | 175 | 242 | 307 | 261 |
| Central Provinces ... | 226 | 120 | 94 | 109 | 149 | 102 |
| Madras ... ... | 194 | 62 | 116 | 116 | 134 | 145 |
| Punjab ... ... | 224 | 148 | 99 | 130 | 146 | 141 |
| United Provinces ... | 155 | 71 | [illegible] | [illegible] | 139 | 94 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 119 | 125 | 53 | 68 | 117 | 149 |
| Burma ... ... | 504 | 198 | 142 | 410 | 159 | 252 |
| Bihar and Orrissa ... | 73 | 63 | 49 | 55 | 65 | 50 |

were spending much more on the services transferred to them. But the inequalities among the Provinces were greater in 1920–21 than in the first year of the permanent settlement. The level of expenditure in Bombay was, comparatively speaking, raised still higher; and Bihar and Orissa was even in a worse position than before. The United Provinces and the Central Provinces improved their position; and there was a large increase of expenditure in Madras on law and justice, education and medical services. The Punjab maintained its position, and Assam was also better off at the end of the period than at its beginning. In the distribution of grants-in-aid Assam received the largest amount in proportion to its population.[1] The Punjab and the Central Provinces had also good luck, while the United Provinces and Bihar and Orissa, whose needs were much greater, did not receive the assistance to which they were entitled. Bengal was a little more lucky than before, and the revenue of Bombay was expanding so very rapidly that even the Government of India felt that it would not do to give it assistance on the scale to which it had been accustomed. Even then it received nearly twice as much as the United Provinces and Bihar and Orissa; and the share of Madras, which even in the past had never been high, was not much higher than that of these unlucky Provinces. The charge that these 'doles' were distributed in a haphazard manner is borne out by these figures, as it is by those relating to the preceding periods.

It is now possible to offer a few observations on the general character of the pre-Reforms settlements. Their salient characteristics may first be summarized. Being based on the estimated needs of the different Provinces, the amounts which they received had no connexion with their revenues. Their income was mainly derived from the divided heads, and though the Government of India laid down the principle that the same share of the chief sources of revenue should be given to each Province to ensure a reasonable equality of treatment, it was not followed in actual practice, and there was a great deal of

[1] Table XVIII.

diversity as regards the percentage of each head of revenue allotted to the different Provinces. This was inevitable, as it was not possible to secure a correspondence between the estimated expenditure of the Provinces and their share of the receipts of the divided heads, if it was to be given on a uniform basis. The same facts accounted for the continuance of the adjusting assignments to supplement the income of the Province from the divided heads. The Decentralization Commission had pointed out the desirability of converting fixed assignments into shares of growing revenue, but this could not be fully given effect to on account of the need of securing an adjustment between the needs of the Provinces and their revenues. The contributions out of the surplus revenues of the Central Government were an important feature of these settlements, and they were larger from 1912–13 to 1920–21 than in the period when the quasi-permanent settlements were in force. The Provinces did not enjoy independent powers of taxation; and the Decentralization Commission was of opinion that these powers should be granted only if there was a more effective control over the Provincial finances by the Legislative Councils. It was held that in the absence of the responsibility of the Provincial Governments to the tax-payers and their representatives, which acted as a check upon increased taxation in other countries, there would be a tendency to cast fresh burdens on them, and specially on the landed interests whose fiscal obligations in respect of Imperial and Local taxation were already very heavy. The Provinces were given a share of growing revenues, but could not levy special taxation to increase their scale of expenditure.

The Central Government exercised considerable control over Provincial expenditure, and this was attributed later on to the system of financial settlements based on Provincial requirements and the existence of the divided heads. It was, therefore, held to be a condition precedent to the relaxation of Central control over Provincial expenditure that the needs of the Provinces should no longer be made a basis of the settlements, and that the divided

heads should be abolished. It is important to understand the real position. There were a few divided heads of expenditure, but those were the heads corresponding to the sources of revenue whose receipts were shared by the Central and Provincial Governments, i.e. land revenue, stamps, excise and income-tax; and as the Provincial Governments were not given wider powers with regard to heads which were wholly Provincial than those possessed by them with regard to the divided heads, the latter could not possibly have been a contributory cause of the circumscription of the financial powers of the Provincial Governments. As regards the divided heads of revenue and Provincial needs being the basis of the settlements, it is to be remembered that the settlement of 1911 was declared permanent with a view to provide the Provinces '*once and for all*'[1] with settlements so framed that all Local Governments could develop their administration from their own assigned revenues. This meant that there could be no occasion for the revision of the estimates of Provincial needs after the introduction of the permanent settlement; and as the Provinces were to determine their own scales of expenditure within the limits of their resources, the necessity of continuing the control of Provincial expenditure could easily have been obviated. When the needs of a government have to be estimated by a superior executive authority, and this has to be done every year, the latter is, of course, bound to exercise a close control over the discretion and liberty of the former to incur expenditure. But that need not be the case if, in the financial relations of the two, is introduced what the Government of India called 'an element of fixity' which throws the responsibility on the subordinate authority of keeping the growth of its expenditure within the limits set by the growth of its assigned revenues. The ostensible purpose of the permanent settlement was to give finality to the financial relations between the Central Government and the Provincial Governments, and should in itself have made it possible for the former to relax their financial control over the latter. As regards the

[1] The G. O. I. Resolution No. 27-F, dated 18 May 1912.

divided heads of revenue, there is even less to be said against them so far as the pre-Reforms limitations of the financial powers of the Provincial Governments were concerned. They received in all cases half the receipts of these heads, and in some cases even three-fourths. They had, therefore, a very strong interest in keeping the administration of these taxes up to a high level of efficiency. It was not necessary for the Central Government to interfere in the details of their administration on account of the fact that they shared the receipts of these taxes with the Provincial Governments. The fraction to which they were entitled being fixed, they could leave the Provinces to husband their resources and get the maximum possible yield out of them through the incentive of their enlightened self-interest.

This argument, of course, leads to the conclusion that these three factors in themselves need not have given the Central Government a motive for imposing restrictions on the financial powers of the Provinces, and not that in actual practice they did not have that effect. The control of the Central Government in the domain of finance was fairly extensive; and these factors had their own share in contributing to this result. This result was, however, due to the whole system of administration under which, in the words of the Joint Report, 'the paramount justification for restrictions on the spending powers of Local Governments . . . . . was the need of ensuring that, in a poor country, official Governments were fully sensible of the duty of economy, and *of making good the lack of effective popular criticism by close control from above*' (italics mine).[1] The Provincial Governments had to submit to these restrictions on account of the basic principles of the whole political structure. The codes, rules and standing orders, the periodical reports and returns, the Inspectors-General, the need of obtaining the previous sanction of the Government of India and the Secretary of State in legislative, administrative and financial matters, all belonged to an order of things which premised the necessity of 'control

[1] Joint Report, Para 113

from above' on account of the constitutional responsibility of the Government of India to the Secretary of State, and of the latter to the British Parliament. The financial settlements, based on needs, and the divided heads were a part and parcel of the whole system of administration, and acquired all the essential characteristics of the latter; but the statement that the control of Provincial expenditure was due to them is a piece of exaggeration, and has to be assessed at its real value. It is necessary to bear this clearly in mind, in order that we may not be biased against certain proposals of financial re-adjustments owing to their superficial resemblance with the pre-Reforms conditions. Under these the Central Government exercised control over the Provinces, which was as rigid as it was far-reaching; but in the revision of the Meston Settlement we have to rid ourselves of all prejudices, and not rule out of court proposals merely because they revive in our minds the memories of the evil days of excessive centralization. This is the only way in which the problems of federal finance in India can be successfully solved.

**Diagram showing the relative position of the different Provinces in respect of Expenditure on District Administration in certain years.**

**(1927–28 omitted on account of the change in classification.)**

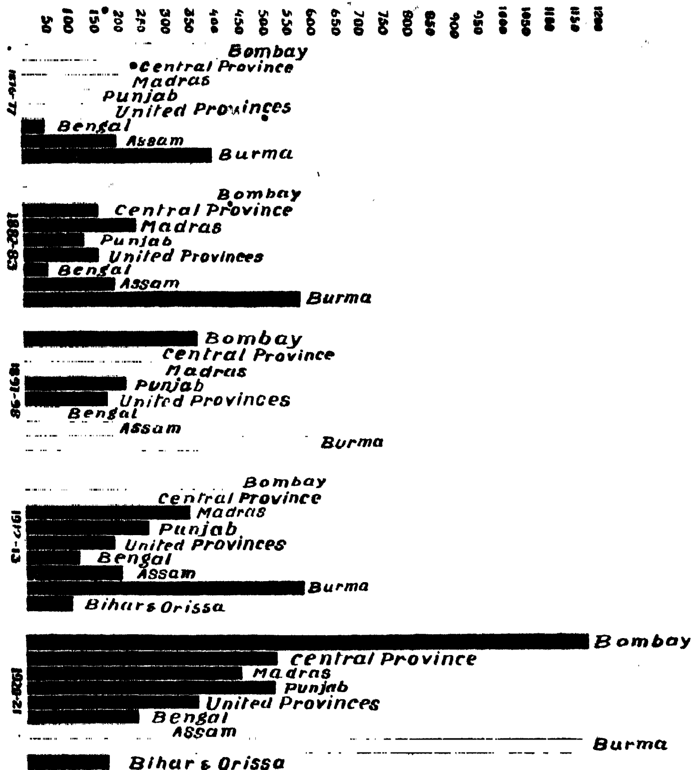


Diagram showing the relative position of the different Provinces in respect of Expenditure on General Administration in certain years.

(1927–28 omitted on account of the change in classification)

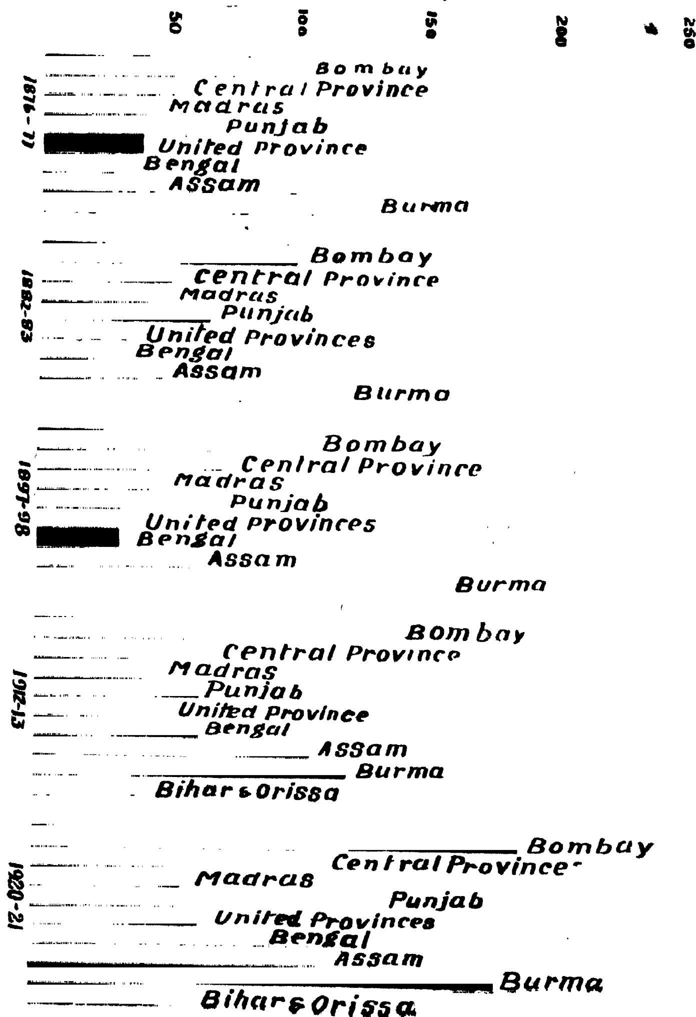


*Diagram showing the relative position of the different Provinces in respect of Expenditure on Law and Justice in certain years.*

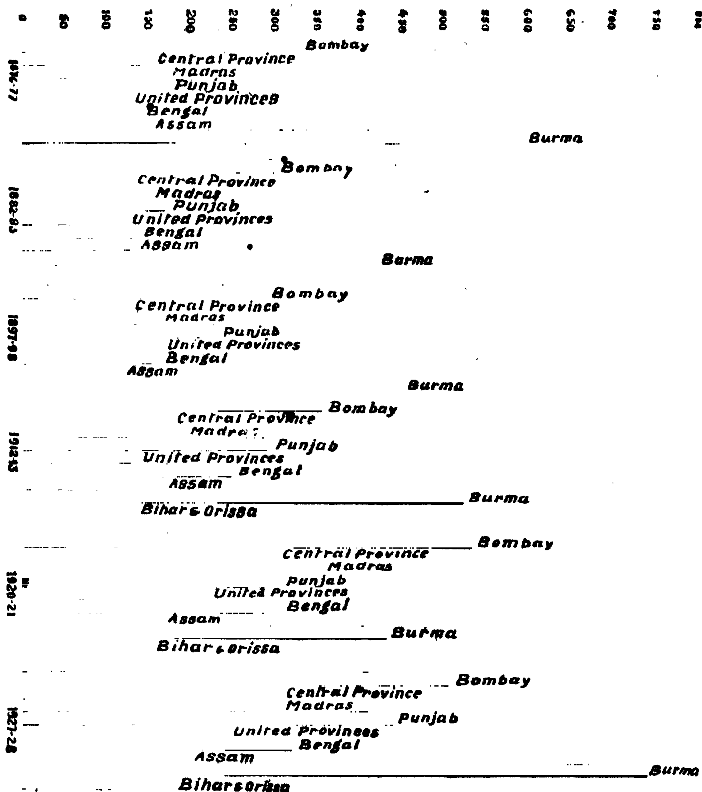


**Diagram showing the relative position of the different Provinces in respect of Expenditure on Police in certain years.**

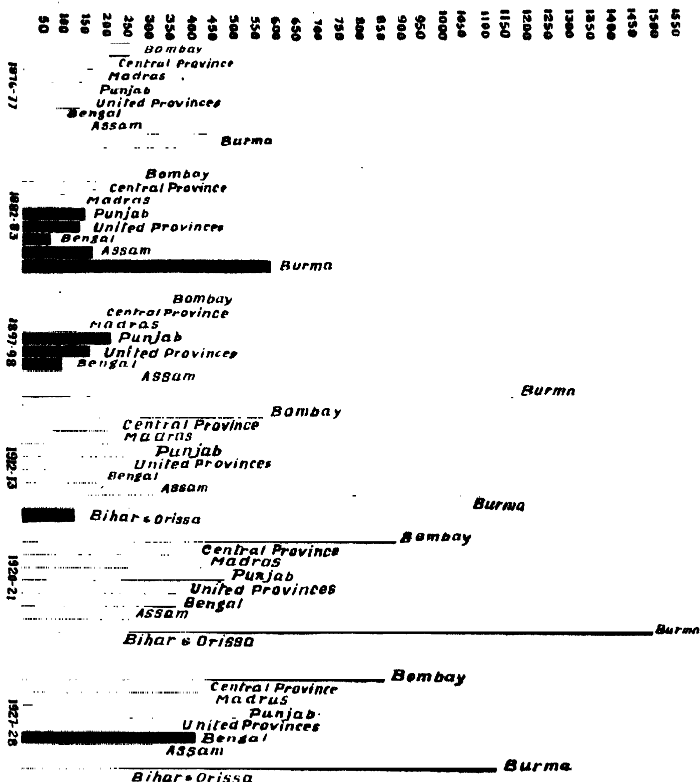


**Diagram showing the relative position of the different Provinces in respect of Expenditure on Education in certain years.**

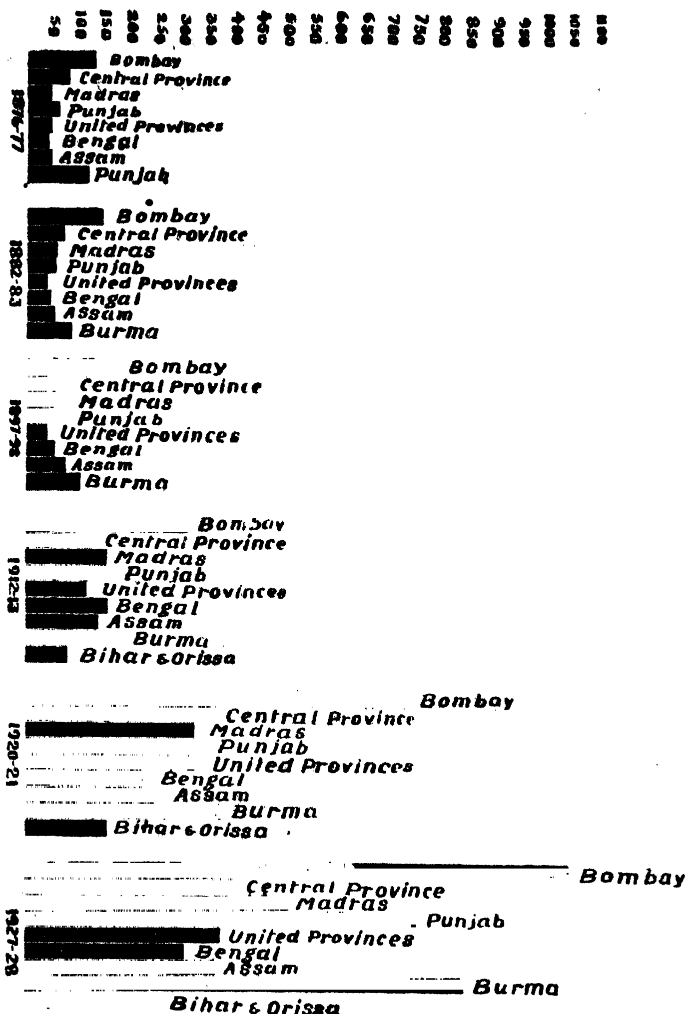
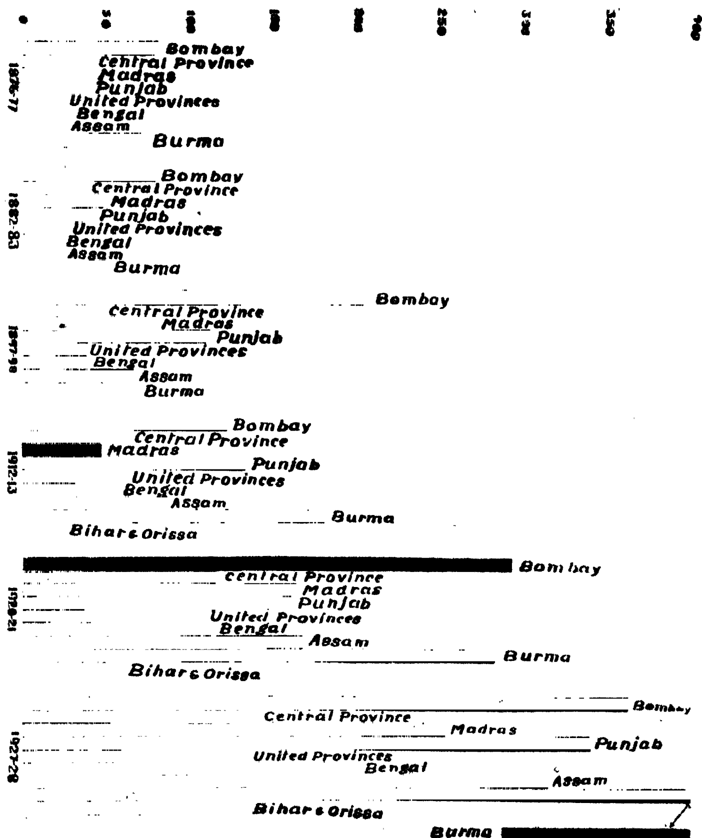


**Diagram showing the relative position of the different Provinces in respect of Expenditure on Medical Services in certain years.**



# CHAPTER III

## *The Meston Settlement and After*

. The financial settlement now in force is generally called the Meston Settlement. It is not quite correct to give it that name, but it may, since it has become current, be used to describe the present allocation of fiscal resources between the Central and Provincial Governments. The introduction of this settlement was a new departure in the development of Provincial finance, and was necessitated by a radical change in the conception of the place of the Provinces in the Indian political system. It was an integral part of the process 'of devolution, of drawing lines of demarcation, of cutting long-standing ties', which was the foundation on which the structure of the Reforms was erected; and it was pivoted on the abolition of the 'divided' heads. The fact that the financial settlements were based on Provincial needs was taken as the cause of the Central control of Provincial expenditure, and as the Government of India took a share of the proceeds of certain taxes, they were considered to have a direct motive for interfering in the details of administration. In view of these considerations, it was taken for granted that the Provinces could not become self-governing unless they adjusted their expenditure according to their income, and there was a definite and complete separation of resources. The new settlement was, therefore, to be based on revenues and not on needs, and made completely free from the 'taint of the divided heads'. There was to be not only separation but also what the Americans call segregation of resources, and expenditure on Provincial subjects from Central revenues was to be completely banned. There was to be no overlapping between the domains of Central and Provincial

taxation, and each authority was to have not only independent sources of revenue, but also an exclusive right to use them for its own purposes, and the other authority was not even to enjoy concurrent powers with regard to them. This was the new doctrine of the financial 'clean cut' which determined and circumscribed the allocation of resources in the new settlement.

The new scheme was, therefore, a corollary of the new system of government which the authors of the Reforms sought to establish in India. It was sketched by them in paragraphs 201–210 of their *Report*, and its fundamental principles were later on accepted as sound by the Government of India, the Functions Committee, the Joint Select Committee of Parliament, and the Financial Relations Committee. These principles, as stated above, started from a new standpoint. The Provinces were to be given the largest measure of independence of the Government of India, and could attain the higher political status which they were to be given only when they had their own financial resources and final powers over their budgets. The Central Government was to have resources for the upkeep and development of services of all-India importance, and all other resources were to be handed over to the Provinces. This did not mean that on the financial side the Provinces were to be granted all residuary powers, for in paragraph 210 of the *Report*, in view of the ultimate responsibility of the Government of India for the security of the country as a whole, the authors of the *Report* definitely provided against proposals which might trench on their field of taxation or in any way impair their supreme authority. But the Provinces were to have large and buoyant sources of revenue for the development of the functions appertaining to their spheres, the vital importance of which for the well-being of the nation had of course to be taken as an admitted fact. The introduction of wide measures of legislative and administrative devolution rendered it necessary that the Provinces should be given distinct and growing sources of revenue.

This decision regarding the disposal of the divided heads gave rise to the difficult problem of their

allocation. It was solved mainly by the consideration of administrative convenience or what Seligman would call efficiency. Each Government was to be given the sources of revenue which properly belonged to it, i.e. those which could be conveniently and efficiently administered by it. Customs, salt and opium were already Central heads, and it was taken for granted that they should be allocated to the Central Government. Land revenue and income-tax, however, were divided heads, and it was necessary to assign them either to the Central Government or to the Provincial Governments. It was proposed to make land revenue a Provincial head on account of its intimate connexion with administration in rural areas. This consideration was held conclusive, and the soundness of the proposal was taken as self-evident. As regards income-tax two reasons were urged in favour of making it a Central head. The first was the necessity for maintaining a uniform rate throughout the country on account of the inconvenience of having different rates in different Provinces. The other was the necessity of avoiding multiple taxation in the case of ramifying enterprises. The complications arising from the difficulty of reconciling the conflicting claims of domicile and status were anticipated by centralizing this important source of revenue. Excise was made Provincial on grounds which cannot be considered adequate in themselves, but were accepted as sufficient by the authors of the scheme. It was stated that excise was to be made a Provincial receipt as it was already Provincial in Bombay, Bengal and Assam, and there was no valid reason why it should not be made Provincial throughout India. The fact that it has been assigned to the central government in all federal countries should in itself have suggested a doubt regarding the soundness of making it a Provincial head in India, but this consideration was not taken into account owing to the horizon being limited by Indian conditions. Stamps were to be Central on account of the advisability of avoiding discrepancies of rates, while court-fees were to be assigned to the Provinces and regarded by them as a means of augmenting their resources. Irrigation was also handed over to the

Provinces on account of its close connexion with land revenue. Forests and registration were already Provincial; and, as in other cases, it was assumed that it was not necessary to disturb the existing arrangements.

This scheme was based on two other assumptions, which were not explicitly stated, but were taken as essentially valid for the division of resources. One was that the interest of equity required that all the Provinces should be given the same sources of revenue ; or, in other words, uniformity was considered necessary for equality of treatment. Till 1920, as already stated, there was no uniformity as regards the percentage of each divided head of revenue allotted to the Provinces in spite of the fact that the Government of India had laid down the principle of uniformity in 1904, and it was endorsed by the Decentralization Commission in 1909. Now, however, the soundness of the principle was accepted as obvious, and it was not felt even necessary to formulate it. In the second place, it was assumed that the resources assigned to the Provinces gave them revenues which were theirs by right, and also that they should adjust their expenditure to them; and it, of course, followed that the receipts from the Central heads were the property of the Government of India and could be used only for all-India purposes. It was held that the scheme gave to the Provinces what was of the Provinces, and gave to the Government of India what was of the country as a whole. By a coincidence, the strangeness of which did not even strike the authors of the scheme, a settlement dictated primarily by the considerations of administrative convenience also answered the needs of equity, and each Government got what was really its own. It was admitted that the scheme under which income-tax was a Central and land revenue a Provincial head would be somewhat unfair to the Provinces which had large industrial and commercial interests, for income-tax was recognized as only the industrial and professional complement of land revenue. But this consideration was not allowed to have any weight in the allotment of revenues, as it was thought that it was impossible 'to extend the principles of equality to individual heads of

revenue'. It was claimed by the authors of the scheme that it secured equality of treatment between one Province and another, and otherwise provided a suitable basis for the new financial settlement.

To this comforting conclusion there was, however, one very important exception. According to this distribution of resources, the income of the Government of India fell short of the expenditure on services for which they were made responsible, and it was necessary to meet the resultant deficit. The authors of the Reforms were hard put to it to suggest methods by which this end could be achieved. They discussed three or four alternative methods, but rejected them all as they did not fit in with the existing facts; and they then proposed to make up the deficit by levying fixed contributions on the Provinces to be assessed as a percentage of the difference between the gross Provincial revenues and the gross Provincial expenditure, both to be calculated on the basis of the proposed scheme for the division of resources and functions. Taking the figures of 1917–18 as the basis of their calculations, they concluded that, if each Province contributed 87 per cent of its gross surplus, the Central budget would be balanced. This proposal laid bare the difficulty which was inherent in the whole scheme, but was not otherwise clearly perceived. The fact that some of the Provinces, under the plan, were to be called upon to bear a much heavier proportion of the Central deficit than others at once challenged attention, and had to be explained. The difficulty was got over by admitting that it was there already, and that there was no way of avoiding it. 'The plan,' it was stated, 'continues the disparity which is at present masked by the system of divided heads.' The worst that could be said against it was that it made the inequalities which were latent in the old settlement patent to the eye, but it was easier to put up with them inasmuch as the contributions were to be a transitional feature of an otherwise even and well-balanced scheme of allocation of resources. This disparity among the Provinces, it was assumed, arose on account of the inequality of their contributions; and, with their cessation, they would all be put on the same footing

and get the resources to which they were entitled by the dispensations of Providence.

The Provinces, which were prejudicially affected by the plan, thought more of the immediate burdens than of the distant gains and lodged vehement protests against it. A scheme by which Madras had to pay five times as much as Bombay, the United Provinces also about five times as much as Bengal, and the Punjab and Burma much more than other and richer Provinces obviously made very invidious distinctions, and could not be tolerated as a necessary evil even for the time being. The Government of India saw the point of these protests, and contended on behalf of the Provinces that an arrangement which undoubtedly disclosed their true position in the past did not justify the continuance of these inequalities in the future. They suggested that the initial scale of contributions should be treated as provisional, and steps be taken to fix a standard scale to be determined on some equitable basis. As the whole question, according to them, needed skilled investigation, they urged that a committee of experts be appointed to enquire into the matter, and recommend the initial and standard scale of contributions. This view was endorsed by the Joint Committee of Parliament, and accordingly a commitee consisting of Lord Meston, Mr. Charles Roberts and Sir E. Hilton Young was appointed to report on the question of contributions.

This committee, which we may henceforth call by its popular name—The Meston Committee—submitted its report with great expedition. The only question which was referred to the committee in the first instance was the question of contributions, and later they were asked to advise whether Bombay should be allowed to retain any share of the revenue derived from income-tax. The Committee found it difficult to treat this issue as applicable to one Province only, and upheld the objections of the authors of the Joint Report against the provincialization of income-tax. Their main task, however, was to suggest the initial and standard scale of contributions. It is necessary to bear this in mind, as generally it is assumed, that the whole financial

settlement was brought under review and reported upon by them.' They, as a matter of fact, stated definitely that since the scheme of re-distribution of resources proposed in the Joint Report had already been approved by the Joint Select Committee they considered it outside their duty to advise any alteration in it unless they found the strongest reason for a change. The only change, which they recommended, was that general stamps should be made a Provincial head throughout India, instead of a Central head, as proposed in the Joint Report. They gave two reasons in support of their proposal. The first was that it was necessary to make this change 'to secure a genuine and complete separation of resources', as otherwise stamps would continue to be a divided head of revenue. The other reason given by them was that, without this change, some of the poorer Provinces would start with little or no surplus, and the initial distribution of the Central deficit would be difficult. They based their calculations on the revised estimates of revenue and expenditure of 1919–20, and fixed the deficit of the Government of India at Rs. 9·83 crores. This amount had to be distributed among the Provinces. They did not approve of the proposal to levy the contributions as an all-round ratio of the normal surplus of the Provinces. This, according to them, was not desirable as there was a difference of opinion regarding the normal standard of expenditure, and a uniform ratio would leave out of account the special needs of particular Provinces. They made allowance for very great disparity in the financial strength of the Provinces, and gave exceptional treatment to Burma, the Central Provinces, Bihar and Orissa, and Assam, and proposed to assess the initial contributions on the increased spending power of the Province, i.e. the additional income which a Province would acquire on the introduction of the new scheme of the separation of resources. They also suggested a standard scale of contributions, which was to be worked up to in seven years, based on the taxable capacity of the Provinces. It is not necessary to say anything about the ideal scale of contributions as it was not incorporated in the settlement approved by Parliament; but the fixed ratios suggested by them as

representing an equitable basis of the relative contributions of the Provinces were based on considerations of a very nebulous character; and the committee, in assessing the relative taxable capacity of the Provinces in the short time which they had at their disposal, betrayed an utter lack of appreciation of the complexity of the task which they had undertaken. This fact, however, need not be stressed any further, as it has no bearing on the present financial position. It is of greater importance to point out the significance of the fact that the Meston Committee modified the original proposals of the Joint Report by attaching some weight at least to the general financial position of each Province, and the more imminent claims upon its resources; in other words they were, to a certain extent, influenced by the consideration of the needs of the Provinces in fixing the initial contributions, and accorded, as stated above, preferential treatment to four Provinces. They did not go far enough in making the adjustment of resources to needs to affect or alter the essential character of the settlement, but they had a dim understanding of the difficulties which the latter sought to evade in vain.

The change was, however, of a very inconsequential character, and the burden of Central expenditure was unevenly distributed in spite of a change in the basis of assessment of contributions. Madras, the United Provinces and the Punjab had to bear 35½, 24½ and 18 per cent respectively of the total initial contribution, making 78 per cent of the whole; while Bengal and Bombay contributed only 6½ and 5½ per cent of the levy respectively. The Meston Committee also followed the line of argument, which had been urged in the Joint Report, in meeting the objection that the scheme imposed disproportionately heavy burdens on some provinces. The contributions were not new or additional burdens. They were only a temporary expedient; and their weight was the best index of the amount of the gains of the Provinces, both immediate as well as eventual, under the new financial scheme. The Provinces which had to pay more were merely asked to forgo for a period the full enjoyment of their ultimate advantages; and all, it was

stated, would be well when the Government of India remitted the contributions, the reduction and the eventual cessation of which was to be the first charge on the improvement of their revenues. The problem of inequalities was considered only as a part of the problem of assessment of contributions, but the fact that inequalities of revenue and expenditure would continue even after the extinction of the contributions was not held to be of any consequence or importance either by the authors of the Reforms or by the Meston Committee.

The Joint Select Committee of Parliament considered the Meston Committee's Report, approved of the fundamental features of the proposals, and were definitely opposed to the provincialization of income-tax. They rejected the scheme of standard contributions, but recommended that the Provinces which had to pay heavy contributions in the beginning should be the first to be benefited by their remission, and laid down a formula according to which the reduction was to be effected. On grounds of policy they gave the Provinces a small share in the growth of revenues from taxation of income so far as the growth was due to increase in the amount of the income assessed. The scheme, as modified by the Joint Select Committee, was embodied in the rules made under the Government of India Act, and is now in operation.

The Provinces were also given powers to impose additional taxes for provincial purposes, and the taxes which could be imposed by them without obtaining the previous sanction of the Government of India were specified in Schedule 1 of the Scheduled Taxes Rules. They included taxes on amusements and betting, succession duties, a tax on non-agricultural land and taxes on advertisements, etc. The Government of India were given residuary powers in taxation as in all other matters.

After the introduction of the Reforms, the Government of India and the Governments of all the Provinces passed through a period of financial stress. The Government of India attributed their misfortunes to war, frontier expeditions, exchange and trade depression. The Provincial Governments were unable to find any

natural calamities, except the failure of the monsoon, to account for their troubles, and fulminated against the Meston Settlement in their inability to balance their budgets. The Meston Committee held out the prospect of 'abundant general resources' and considered it an unthinkable sequel to the Reforms that the Provinces should embark on new taxation at the outset of the new era. They also saw no justification for the Government of India imposing fresh taxation for carrying on the administration of Central subjects. For the first three years of the Reforms all the Governments in India had to face enormous financial difficulties, and the efforts to overcome them involved a very great strain on their resources and good temper.

The Meston Settlement became a by-word for financial iniquity and injustice, and the frequency with which it was condemned both by officials and non-officials convinced the general public that the case against it admitted of no difference of opinion. The Government of India, pressed on all sides for assistance, found it impossible to afford any relief, on account of their own financial difficulties. They, however, made an exception in the case of Bengal, and in 1921, on the recommendation of the Finance Member, the Legislative Assembly agreed to the remission of the Bengal contribution for a period of three years. This concession gave the much-needed relief to Bengal, but did not improve the general atmosphere. The protests of the other Provinces became more vehement than ever, and the tension of feeling over the question was increased on account of the prevailing political distrust and suspicion. A conference of Finance Members at Simla was called in April 1922. Various proposals for easing the situation were discussed and the whole position reviewed at some length, but no change was made in the financial settlement. The Government of India decided to uphold it, and once more repeated their promise to treat the abolition of the Provincial contributions as the first charge on the betterment of their revenues. Since the remission of the Provincial contributions, Madras, the United Provinces and the Punjab have adopted a more quiescent attitude.

They consider their abolition merely an act of tardy justice, and feel that the financial outlook, so far as they are concerned, is quite hopeful. Their revenues can never be in excess of their needs; but they are sure to expand, and provide them with funds for the development of their vital services. But other Provinces still hold that, without the revision of the whole settlement, their future is far from reassuring, and expect that the next step in constitutional advance will not only give them wider power, but also larger resources to enable them to use those powers to the advantage of their people. There are not many who understand the Meston Settlement, its genesis and subsequent developments. But there is a general feeling that it is to go, and make room for a more generous and equitable financial arrangement. The psychological atmosphere is full of hopes of change for the better, and it is necessary to take this general expectation into account in making the financial re-adjustments. The prejudice against the Meston Settlement is very strong; and though, like all prejudices, it has very little rational basis, it cannot be summarily dismissed on that account.

It is necessary to examine the position a little more in detail to understand its full significance. This cannot be done without acquiring a closer acquaintance with the financial history of the Reforms period; but before dealing with this it is desirable to give an account of some of the concrete proposals which have been made during the period in order to get an idea of the general trend of subsequent discussions. The Reforms Enquiry Committee of 1924 considered the problem of finance, and expressed the opinion that the difficulties arising therefrom formed one of the main obstacles to the success of the Reforms. They urged the need of reducing the Provincial contributions; but as that in itself could not meet the needs of certain of the Provinces, they considered that a revision of the whole settlement was inevitable, and should be undertaken as soon as a favourable opportunity occurred. They themselves, however, did not make any recommendations owing to the absence of definite information which could be made the basis of a revision.

The question was again examined at some length by the Taxation Enquiry Committee. The Committee was not required to consider the equity of the Meston Award, but only to indicate the theoretically correct principles of distribution of taxes between Imperial, Provincial and Local. Sir Basil Blackett, in his speech in the Legislative Assembly on 18 September 1924, stated that the taxation enquiry was an essential preliminary to framing a more satisfactory settlement. The Committee was not expected to enquire into the expenditure side of the question. Their function was to suggest what may be considered as a scheme for the ideal division of resources. Being debarred from dealing with the practical issues, their treatment of the problem was lacking in precision, and conveyed an impression of their inability to come to close grips with its realities. They pointed out certain general tendencies relating to the division of taxes in other federal countries, but stated that there was no ideal system for the division of sources of revenue, and the allotment of taxes, owing to historical and other factors, had everywhere to be supplemented by further adjustments. They based their proposals on the assumption that all Provinces would be treated alike. Their object was to devise a satisfactory method by which the redistribution of resources could be brought about without disturbing the existing equilibrium. They did not recommend any change in the present allocation of land revenue, irrigation, fees including judicial stamps, import duties and revenue excises. They were in favour of general stamps, excise on country-made 'foreign' liquors and the whole of the revenue from opium being transferred to the Central Government; and they also suggested the use of export duties, a 'basic' rate of restrictive excises and the probate duty as balancing factors, which presumably meant that export duties might be provincialized, and the probate duty and a basic rate on restrictive excises centralized, if it was necessary to introduce these changes in the interest of an equilibrium of revenues. But they wanted these balancing factors to be used only in case of real necessity.

As they advocated the transfer to the Central Government of general stamps, excise on country-made foreign liquors and opium revenue on administrative grounds, they mainly relied upon the division of the proceeds of the income-tax for restoring the equilibrium. They also discussed the alternative methods by which the receipts of the income-tax could be divided, and recommended that the Provinces should be given the proceeds of a basic rate on personal incomes, graduated proportionately to the general rate, to which would be added a small fraction of the receipts from the corporation-tax, in order to give 'a partial recognition to the principle of origin' in assessing taxable capacity. The basic rates for the income-tax and the corporation-tax were to be determined, with a view to give the Provinces a share of the proceeds of these taxes equal to the revenues which the Provinces derived from the sources, which, under their plan, were to be centralized. They did not realize that the same basic rates would not do as compensating factors in the case of all the Provinces on account of the variations in the yield of these taxes in the different Provinces. But the Committee was not concerned with the effects of their recommendations on Central or Provincial finances. Their duty was to recommend an allocation of resources which gave to the Central and Provincial Governments sources of revenue which appertained to their respective spheres, and could therefore be efficiently administered by them. The inequalities were to be adjusted by the use of balancing factors; and they took it for granted that the present distribution of the total revenues of India between the Central Government, on the one hand, and the Provincial Governments, on the other, was not to be disturbed. The scheme was of some theoretical value in the sense that it sought to carry further the principle of administrative efficiency in the allocation of the sources of revenue; but, as a practical solution of the problem of federal finance in India, its value was strictly limited.

The recommendations of the Taxation Enquiry Committee were carefully considered by the Government of India. They rejected the proposals to centralize the

excise duty on country-made foreign liquor and the excise on opium owing to administrative and other difficulties. They were willing to centralize general stamps; but, on account of the opposition of the Provinces in which it had been an elastic source of revenue, it was ultimately suggested that only duties on documents which were of a commercial and quasi-commercial character should be transferred to the Central Government. The proposal of the Taxation Enquiry Committee to compensate the Provinces for the loss of revenue from general stamps by giving them the proceeds of a basic rate on personal incomes, graduated proportionately to the general rate, was not accepted by the Government of India. They considered that the adoption of a graduated rate would be inconvenient both from the point of view of the Central Government and of the Provincial Governments, since it would create complications in the event of a decision to alter the rates or to adopt a new system of graduation. They, therefore, suggested an alternative method for the division of income-tax, by giving the Provinces a share of income-tax, calculated at the rate of three pies in the rupee on personal incomes from all sources of assessees resident within each Province. This proposal was made on the assumption that domicile was a satisfactory criterion of liability to taxation so far as the Provinces were concerned, and a flat rate assessed on personal incomes would, therefore, be a suitable device for giving the latter a share in the proceeds of income-tax. There is nothing to be said against this as a makeshift arrangement; but, as the object of the proposal is not to disturb the equilibrium of revenues under the Meston Settlement, its intrinsic importance as a means of permanent re-adjustment is limited on that account. The Government of India also rejected the Taxation Enquiry Committee's proposal to give the Provinces a small share of the receipts of the corporation-tax, as the distribution of the tax on companies, according to them, could not be made without making assumptions of an extremely hypothetical character. These proposals were discussed in the Conferences of the Financial Representatives of the Provinces held in

1926 and 1927; but, as each Province wanted to get as much and give as little as possible, it was decided to put off the whole question and let its settlement await the deliberations of the Statutory Commission. The Meston Settlement, along with the constitution of which it is an integral part, is now in the melting pot; and there is, as stated above, a general expectation that it will be replaced by an arrangement which will provide ampler scope for the free play of the dynamic forces of national life. However that may be, it is clear that the theoretical scheme for the distribution of resources, suggested by the Taxation Enquiry Committee, has never received official countenance, and need not be further considered.

We now can undertake a review of the financial events of the Reforms period. The position of the Government of India may first be considered. The year 1921–22 opened in very unpropitious circumstances. It was the intention of the authors of the Joint Report and that of the Meston Committee that the Central Government should be given adequate revenues to meet the expenditure of the functions assigned to them; but the actual developments belied this expectation, and the equilibrium between revenue and expenditure, for the attainment of which they had incurred so much odium, could not be realized. The budget, which the Finance Member presented in 1921, showed that the anticipated surplus of $10\frac{1}{2}$ crores of 1920–21 had been converted into an actual deficit of $11\frac{3}{4}$ crores by the Afghan War, the frontier operations, the trade depression and the vagaries of exchange and, what was worse, the estimates for 1921–22 revealed a deficit of $18\frac{1}{3}$ crores. The Finance Member held that the deficit was not solely due to temporary and transient causes, and that it was necessary to impose additional taxation if India was not to slip down 'the hell of financial demoralization' which had led so many countries to national bankruptcy. He proposed additional taxation, which was calculated to yield Rs. 19·17 crores and leave a surplus of 84 lacs after meeting the deficit of $18\frac{1}{3}$ crores. Next year, however, the revised estimates of 1921-22 showed that expenditure was in excess of revenue by 34 crores on account of the increase of

charges and the falling-off of receipts, and the actual deficit for 1920–21 was 26 crores instead of 18 crores. The outlook for 1922–23 was not more cheering, and a deficit of 31$\frac{3}{4}$ crores was anticipated. The Finance Member once again pointed out that their financial difficulties were not due to temporary causes. 'The problem before us,' he said, 'is one that cannot be shelved or left to look after itself.' The only way out of the difficulty was to levy additional taxation, proposals for which were put forward by the Finance Member and were expected to bring extra revenue of about 29 crores. Some of these proposals were very unpopular and were rejected by the Legislative Assembly, and the uncovered deficit was increased from 2$\frac{3}{4}$ crores to 9 crores. In response to the insistent demand for economy in Central expenditure, a committee, commonly known as the Inchcape Committee, was appointed in the latter part of 1922 to recommend measures for effecting reductions in the expenditure of the Central Government. The Committee, after a careful scrutiny of the expenditure of every department, recommended reductions amounting in all to Rs. 19$\frac{1}{4}$ crores.

The budget for 1923–24 again showed that the financial position and outlook were anything but reassuring. Sir Basil Blackett, who assumed the charge of Indian finances a few weeks before the introduction of the Budget for 1923–24, dwelt at some length on the unsound financial position of the country and pointed out how India had come perilously near the limit of safety on account of the deficits of five years in succession. The deficit for 1922–23, according to the revised estimates, was 17$\frac{1}{2}$ crores instead of 9 crores; and in spite of the fact that the Government of India proposed to effect economies to the amount of about 12 crores, as recommended by the Inchcape Committee, the anticipated deficit for 1923–24 amounted to 5·85 crores. The Finance Member proposed to cover this deficit partly by crediting to revenue the interest from the investments in the Paper Currency and Gold Standard Reserves, and partly by doubling the salt-tax. The latter proposal evoked a storm of opposition, and was rejected by the Legislative

Assembly, The Government of India being convinced of the imperative necessity of balancing the budget, the Viceroy certified the Finance Bill, including the enhanced salt duty. The reactions of this step on the political situation were distinctly disturbing; but what Sir Basil Blackett called 'the rake's progress' in Indian finances was thereby arrested, and budget equilibrium established.

The position continued to improve from 1923–24 onwards, and the Government of India have since then been enjoying a period of financial prosperity. The revised estimate of 1923–24 showed a slight deficit of Rs. 38 lacs; but the actuals of the year produced a surplus of Rs. 2·39 crores, exclusive of a windfall of Rs. 4·73 crores representing profits accruing to India from the sale of enemy ships. According to the forecast for 1924–25, a surplus of Rs. 3·36 crores was estimated. As this was regarded as a real surplus, the Government of India proposed to utilize a sum of Rs. 1·82 crores in reducing the salt-tax from Rs. 2–8–0 per maund to Rs. 2 per maund, and a sum of Rs. 1·5 crores in reducing the Provincial contributions. The Finance Member did not make any secret of the fact that he himself was in favour of applying the whole of the surplus to the reduction of the Provincial contributions, keeping the salt-tax at the higher level to which it had been raised in the previous year; but as he knew that this course would not commend itself to the Legislative Assembly, he proposed this compromise as a measure which would satisfy public opinion, or what he regarded as popular prejudice, and also make a beginning 'in dealing with this running sore of Provincial contributions'. The Legislative Assembly did not agree even to this compromise, reduced the salt-tax to Rs. 1–4–0 per maund, and pronounced (in the words of Sir Basil Blackett) 'a message of despair to all those who were looking forward to expenditure for the amelioration of the conditions of life and for improved educational and sanitary expenditure throughout India'.

Since 1924–25 there have been recurring surpluses. The next year brought a surplus of just under four crores

instead of the modest balance of 18 lacs allowed for in the original budget; and the budget estimates for 1925–26 disclosed a surplus of Rs. 3·25 crores. The Government of India decided to apply Rs. 2·5 crores for the reduction of Provincial contributions, and to keep 75 lacs as a margin against possible misadventures. The reduction of Provincial contributions was granted in accordance with the order of priority laid down in the Devolution Rules. In 1926–27 the surplus of the Government of India was Rs. 3·05 crores. They devoted Rs. 1·25 crores to the further reduction of Provincial contributions; and Rs. 1·75 crores were disposed of by the abolition of the cotton excise duty, which had already been suspended in December 1925. In 1927–28 the Provincial contributions were practically abolished. Though the remission of Rs. 2·58 crores was definitely declared temporary, it was known that, unless events took a very unfavourable turn, the contributions would not be revived. Sir Basil Blackett spoke of this achievement with very great satisfaction, and referred to the advantages which would accrue to the Provinces in having additional resources at their disposal. 'Ever since the Reforms have been inaugurated,' he said, 'the Provincial contributions have been a millstone round the neck both of the Central Government and of the Provincial Governments, poisoning their mutual relations and hampering their every action. Their quality more than their amount has strained the resources of the giver and the patience of the recipient. They have brought curses and not blessings, both to him who has given and to him who has taken. The year 1927–28 sets India free from their incubus'.

In 1928–29 the Government of India again anticipated a surplus of Rs. 2·63 crores, which enabled them to bring about a complete and final abolition of the Provincial contributions. Just now the margin between Central revenue and expenditure is not wide; but it may be assumed that it will continue to increase if the tendencies, which have been at work in recent years, are allowed to produce their full effect. Sir Basil Blackett expressed the view that, with the extinction

of the contributions, it would be possible for the Central Government to satisfy the claims of the tax-payers. The Government of India have already reduced Central taxation by the abolition of the cotton excise duty, the reduction of the salt tax and several other minor changes. There are, however, other claims on the Central revenues which till now have been ignored. But the fact that the Central Government have climbed the steep hill of financial recovery is a great advantage in itself; and though it has, to adapt the words used by Sir Basil Blackett in his budget speech of 1925, brought us within a distant view of still higher peaks, it is possible to take an optimistic view of the future.

Improvement in the finances of the Central Government is not to be measured merely by the extinction of the Provincial contributions or the restoration of budget equilibrium, great as these achievements are in themselves. The Government of India have since 1924 secured several other important gains. The unproductive debt of India has, during this period, been reduced from Rs. 250 crores in 1924 to Rs. 178 crores in 1928. By the introduction of the Debt Redemption Scheme, definite provision has been made for the progressive reduction of public debt; and, though there is a difference of opinion regarding the advisability of adopting this ambitious policy, the introduction of the scheme must be counted as a major achievement of this period. The separation of railway finance from general finance and the institution of the depreciation and reserve funds have, besides emancipating the railways from the control of the Finance Department, been a source of strength to the latter, and made it possible for it to finance its ways and means programmes with greater ease. The balances have also been drawn upon to a considerable extent for capital expenditure; and the Government of India have, on several occasions, been able to find money for outlay chargeable to loan funds without fresh borrowing in India or in England. The credit of India has, as a result of these measures, been raised; and the situation is otherwise well in hand. The victory of the Government of India over adverse circumstances is a great asset; and,

now that we are straining our eyes to the vision of the future, we can do so with an assurance that reconstruction can proceed on sound foundations.

In Table XXXVIII the figures of revenue and expenditure of the Central Government under principal heads are given. The only head of revenue, the yield of which has increased considerably during the period, is customs. This increase is due to the enhancement of the general tariff rate and the imposition of 'protective' duties, the receipts from the latter being about Rs. 1½ crores. The revision of the tariff schedule with a view to framing what may be called a scientific tariff, has been, as is well known, long overdue; but if the policy of maintaining taxation at the present level is to be adhered to and the duties as a whole kept as high as they are now, the yield from customs can be expected to grow steadily. There is a great deal to be said against customs on account of their undesirable reaction on economic life in general, and their incidence on the poorer classes; but in view of the necessity of providing funds for development it will be short-sighted to reduce these duties in order to afford relief to the tax-payers. The other two important sources of revenue are the income-tax and the salt-tax. Income-tax has not shown much capacity for expansion on account of the trade depression, but now that the tax has been modernized and the administrative machinery brought to a higher level of efficiency, it should contribute to the expansion of the Central revenues. The salt-tax yields about Rs. 7 crores and is still an important source of revenue for the Central Government. If the present rate is maintained, its revenue will increase, though not very rapidly. The contribution of railways to the Central revenues is likely to increase; but whether it can be depended upon to give greater elasticity to Central revenues will be determined by considerations of policy regarding which something will be said in Chapter VII. The net receipts from opium amount to about Rs. 2·5 crores, but it will disappear as a source of Central revenue in a few years on account of the stoppage of the opium export to foreign countries.

The only important function for which the Central Government is responsible is defence, and the expenditure on defence during this period has been reduced from Rs. 69 crores to Rs. 55 crores. The Inchcape Committee suggested a standard figure of Rs. 50 crores. It should not be impossible to reduce the military expenditure to that figure; and if the Government of India is responsive to public opinion, it should even be possible to attain the standard of 43 crores adopted by the Meston Committee as a basis of their calculations. The expenditure on civil administration has been slowly rising; but as prices are falling and increments to salaries have already been granted, it may be expected that this item of expenditure will not throw an additional burden on Central revenues unless the Government of India assumes new functions. The conclusion is, of course, obvious that the growth in the revenues and decrease in the expenditure of the Central Government will be an important factor in the financial re-adjustments of the future. The only consideration that can be urged against it is that the Central Government has to be prepared for war, and ought to have a sufficient margin for emergencies. With the general tariff rate at 15 per cent and the present rates of income-tax, which are by no means low, the margin for emergencies is very narrow; and the argument that, if the rates of these taxes are not appreciably reduced, there will be very little reserve for emergencies like war, is valid as far as it goes. But it cannot be pressed very far. The Government of India should, if they follow the policy demanded by enlightened public opinion in India, keep out of wars, the financial burden of which can be properly thrown on the Indian exchequer; but even if this consideration is not given the weight that it deserves, it will be wrong to shape the taxation policy of India to provide her with fiscal reserves for these emergencies. War has become such a big enterprise that no country can expect to meet its cost by taxation. It is necessary to have recourse to borrowing on a large scale for the purpose; and to delay the development of the country, by reducing taxation with a view to hold in reserve the potential taxable

capacity of the people, is as useless as it is short-sighted. It is worth while to take a little risk in order to accelerate the rate of national progress so that the people may be able to rise to a higher level of achievement, and at the same time be better fitted to bear the fiscal burdens of war. A high level of taxation is, from this point of view, itself an insurance against wars and other contingencies.

# CHAPTER IV

## *The Meston Settlement and After*—(continued)

It is now necessary to examine the financial position of the Provinces during the Reforms period. This will have to be done in respect of each Province individually because a general survey of their collective position, though useful in some respects, will not disclose some of the most vital facts of the present situation. The Provinces may be taken in order of the size of their population.

### *Bengal*

Bengal, of course, comes first, and the peculiarities of its financial position lends to its study a special interest. Under the Meston award, the normal revenue of Bengal was fixed at Rs. 8·57 crores; and the conference of Provincial representatives, held in September 1919, fixed its normal expenditure at Rs. 7·91 crores. The Government of India, however, later on admitted the inadequacy of this scale and fixed it at Rs. 9 crores. The actual expenditure [1] of Bengal in 1921–22 was Rs. 10·48 crores, and its revenue Rs. 8·32 crores. There was, in other words, a deficit of Rs. 2·16 crores. Since then Bengal, but for a small deficit of Rs. 21 lacs in 1926–27, has been able to balance its budgets; and, according to the revised estimates for 1928–29, Bengal will have a revenue of Rs. 12·17 crores,[2] an expenditure of Rs. 11·83 crores, and a closing balance of Rs. 2·53 crores. This seems to show that Bengal is doing fairly well; and its financial position, in spite of a very large deficit in 1921–22, has not been unsatisfactory during this period. This result has, however, been achieved by exercising rigid economy and imposing additional taxation. During

[1] Table XXV. [2] Ibid.

the first two years of the Reforms, Bengal undertook retrenchment to the extent of Rs. 89 lacs and Rs. 49 lacs respectively, and levied additional taxation which was expected to yield Rs. 104 lacs. The figures[1] of expenditure show that the Bengal expenditure on education, sanitation and other beneficent departments has not expanded to any considerable extent. The increase of expenditure on education from 1921–22 to 1927–28 was 22 lacs, on medical services about Rs. 18 lacs, and on other departments Rs. 5 lacs. There was an increase of Rs. 13 lacs in expenditure on general administration, but on police and law and justice expenditure was practically stationary. Bengal has, since 1922–23, received a concession in the form of the suspension of its contribution to Central revenues; but the Government of Bengal has, ever since the introduction of the Reforms, maintained that the injustice done to Bengal under the Meston Settlement has nothing to do with the question of contributions, and that the extinction of the latter does not in any way weaken their case for a thorough overhauling of the whole settlement. They have never lost an opportunity of pressing their point of view on the attention of the general public and the Government of India, and have urged persistently that the financial settlement was wrong *ab initio* and treated Bengal most unfairly.

The difficulties of Bengal are due to the inelasticity of its resources. The principal heads of revenue in this Province yield receipts which are quite inadequate for its needs and are not capable of expansion. Land-revenue is, it need not be said, an inexpansive source on account of the existence of the Permanent Settlement, and so long as the latter is treated as sacrosanct, it is not possible to impart elasticity to the revenues of Bengal. The increase under excise and stamps[2] during the period is 47 and 73 lacs, respectively. In 1921–22 there was a sudden decline in excise revenue on account of an extensive propaganda against the use of excisable articles, and the revenue in 1922–23 exceeded that of the

[1] Table XXVIII. [2] Ibid.

previous year by about 19 lacs; the net increase therefore, in excise receipts may be taken at about 28 lacs. The increase in stamps revenue is due to the revision of fees, judicial and non-judicial, and it is not possible to raise them much higher to augment the Provincial revenues. There has also been an increase of receipts under forests and registration. But these are minor sources of revenue, and cannot be used to develop the resources of this Province. Bengal has levied what are known as the scheduled taxes, and increased its revenues by Rs. 20 lacs, but it is very unlikely that there will be any substantial growth in the receipts from these taxes unless a succession duty, which is also a scheduled tax, is levied and fully developed. The Meston Committee referred to the inelastic revenue and low scale of expenditure of Bengal in their report; but, in view of 'its size, intrinsic wealth and general economic possibilities', they did not consider it right to differentiate in its favour in the assessment of the Provincial contributions. Its size, wealth and possibilities, whatever they were, are still there, but it is extremely doubtful whether they will help the Province to find a margin for development. Bengal has, since the inauguration of the scheme of decentralization, received much less than its due; and though it has partly itself to thank for its inadequate revenues, it has certain claims on the Government of India, which the latter will have to take into account in any equitable scheme of re-allocation of resources.

### *United Provinces*

The Meston Committee estimated the normal revenue of the Province at Rs. 12·32 crores, its normal expenditure at Rs. 10·75, including the Rs. 2·40 crores of the contribution to the Government of India, and its additional spending power at Rs. 1·57 crores. The actual revenue for 1921–22 was Rs. 10·02 crores, and the expenditure Rs. 11·49 crores; and there was a deficit of Rs. 1·47 crores.[1] This year was followed by four years of

[1] Table XXV.

deficits in succession, and the total deficit up to 1925–26 amounted to over Rs. 3 crores. This was, to a certain extent, due to falling-off of receipts; but the principal cause of the financial difficulties of the Province was increase in expenditure, which in the first two years of the Reforms amounted to Rs. 2·84 crores. The revision of pay of services and establishment alone cost Rs. 1·52 crores, and there was an increase on all other heads of expenditure. The successive deficits were met from the Provincial balances and the funds obtained from a loan raised in the open market. The United Provinces Government put an unwarranted construction on the word 'productive' expenditure, used the loan funds for charges which should have been met out of revenue, and violated the letter as well as the spirit of the rules under which the Provincial Governments are allowed to raise their own loans. The Accountant-General pointed out this irregularity in his Appropriation Report, and the Government of India had to warn the United Provinces Government that no loan would be sanctioned, whether raised in the open market or obtained through the Provincial Loans Fund, if its proceeds were applied in practice for meeting the revenue deficit. The era of deficits came to an end in 1926–27, and for the last two years this Province has been able to balance its budgets and make provision for considerable surpluses. This has been rendered possible by the remission of its contribution of Rs. 2·40 crores by the Government of India. The estimated revenue and expenditure for 1928–29 were Rs. 12·47 crores and Rs. 11·95 crores,[1] respectively; and since the latter amount does not include the contribution, it means that expenditure in 1928–29 was estimated to exceed the actual expenditure of 1921–22 by Rs. 2·86 crores. The prospect for the United Provinces is now quite satisfactory, and its financial position fairly good. But its scale of expenditure is, as it has always been, low; [2] and it has even now to make up what the Meston Committee called considerable arrears of administrative progress.

[1] Table XXV.
[2] Tables XXVII and XXVII (*a*)

There has not been much additional taxation in the Province during this period, though court fees and water rates have been raised. The receipts under stamps, and irrigation[1] in 1927–28 show considerable increase, as compared with 1921–22; but excise, which has, in almost all Provinces, yielded growing revenue, has not in any way contributed to the increase of the revenues of the United Provinces, and its total yield in 1927–28 was less than that of 1921–22 by about Rs. 10 lacs. The incidence of the excise duties in the United Provinces in 1926–27 was the lowest among the major Provinces,[2] and it may be possible to increase the revenue from this source by revising the rates. This Province should to a certain extent be able to enlarge its spending power by developing its fiscal resources.

*Madras*

Madras, like the other Provinces, had to face great financial difficulties in the first two or three years of the Reforms; but its financial situation is now, to use the language of the money market, distinctly easy. The Meston Committee anticipated that it would have additional spending power of Rs. 2·58 crores, after paying the contribution of Rs. 3·48 crores to the Government of India. In 1921–22 it had a deficit of Rs. 99 lacs; and in spite of additional taxation of Rs. 77·5 lacs[3] and considerable reduction of expenditure, there was an anticipated deficit next year of Rs. 42 lacs. During these years its protests against the contribution were vehement, and Madras was often spoken of as the 'milchcow' of India. In 1923–24, however, the position considerably improved; and since then Madras has been, in spite of the provision for fresh expenditure under various heads, realizing large surpluses; and its balances, which had been reduced to Rs. 17 lacs in 1924–25, have again risen to Rs. 4·85

[1] Table XXIX.

[2] The incidence per capita in the different provinces in 1926–7 is as follows:—Bombay Rs. 2-1-10, Madras 1-3-4, Burma 1-0-0, Central Provinces 0-15-7, Assam 0-15-2, Punjab 0-9-7, Bihar and Orissa 0-9-3, Bengal 0-7-9, United Provinces 0-4-9.

[3] Table XXV.

crores in 1929–30. During this period large sums have been spent on the repayment of loans and on capital expenditure out of revenue. The estimated revenue of 1928–29 was Rs. 16·97 crores and the expenditure Rs. 16·95 crores. The expenditure on education has increased by Rs. 72 lacs from 1921–22[1] to 1927–28, on medical services by Rs. 12 lacs, and on general administration by Rs. 93 lacs. The improvement in the financial position of Madras is due to the remission of its contribution to the Central Government and an increase in the yield of taxes. The Meston Committee expected that Madras would, under their plan, receive 'a windfall so vast as would not be profitably employed for several years'. As a matter of fact, however, Madras could not, as stated above, even balance its budgets in 1921–22, but it is now the lucky recipient of a 'windfall' the spending of which will require a great deal of careful thinking. 'There has been,' as was admitted by the Finance Member in his Budget speech of 1929, 'a scramble for funds among the departments; every time that there was a remission in the contribution, money was allotted to them, with the result that, not having any far-seeing objective or well-planned programme, they spent away as best as they could.' The Finance Member also spoke of 'the immensity of the needs which have still to be met'. The unsatisfied needs of Madras, as of the country as a whole, are immense, and any amount of money can be usefully spent on progressive schemes; but the scale of expenditure[2] in Madras cannot be described as unduly low, and it will be idle to deny that Madras now finds itself in possession of funds, the largeness of which is embarrassing for the time being, though they can certainly be used to very great advantage when well-considered and well-matured schemes are taken in hand.

There has also been a great expansion of revenue in Madras. It has increased from Rs. 11·75 crores[3] in

[1] Table XXX.
[2] Tables XXVII and XXVII (*a*).
[3] Table XXV.

1921–22 to Rs. 16·97 crores in 1928–29. Land revenue receipts increased from Rs. 6·07 crores in 1921–22 to Rs. 7·55 crores in 1927–28, stamps revenue from Rs. 1·09 crores to Rs. 2·45 crores, and excise receipts have also shown an upward tendency in the last two years.[1] The financial position of Madras, both in respect of revenue and expenditure, compares well with that of the other Provinces, and the incidence of its burden in the early years of the Reforms is also the measure of its gains at the close of this period.

*Bihar and Orissa*

In contrast to the United Provinces and Madras, Bihar and Orissa is very unfortunate; and its position is now, as it has been since 1912–13, a complete anomaly in the scheme of financial decentralization. Judged by the figures of surpluses and deficits, this Province has not done badly as compared with the other Provinces, for, till 1925–26, it achieved what was not possible for most of the other Provinces, i.e. equilibrium between revenue and expenditure. For the last three or four years it has not been able to avoid revenue deficits ; but these amounts are not large, and Bihar and Orissa has, on the whole, been able to make both ends meet. But to say this is to say very little, and that little has no significance so far as the real financial position of the Province is concerned. Among the nine major Provinces, Bihar and Orissa stands fourth in point of area and population, but both in respect of revenue and expenditure per thousand of population it stands lowest. It occupied that position in 1912–13, in 1920–21, in 1921–22 and 1928–29, and there is no prospect of its being able to make up the lee-way with the present distribution of resources. The origin of this disparity has already been explained, and it is impossible to view its future without dismay unless this Province is placed in a position to increase its fiscal resources. During the Reforms there has been some increase of expenditure. The total expenditure has increased from Rs. 4·58 crores in 1921–22 to Rs. 5·88

[1] Table XXX.

crores in 1928–29 ; the expenditure on education has risen from Rs. 55 lacs in 1921–22 to Rs. 86 lacs in 1927–28, on medical services from Rs. 21 lacs to Rs. 46 lacs and on other beneficent departments from Rs. 12 lacs to 24 lacs.[1] There has also been a slight increase of expenditure on general administration, police and law and justice. This again appears at first sight quite satisfactory. The expenditure on education is up by about 60 per cent., and on public health and other beneficent activities by more than by 100 per cent. This compares well with Bombay, where the expenditure on education has risen only by 17 per cent, and on other heads not even in that proportion. In one way such a comparison is very misleading, but it has been made to show that progress in the industrial Provinces has not been as rapid as in the agricultural Provinces. In spite of the remarkable progress in Bihar and Orissa, the industrial Province of Bombay spends about four times as much per head on education, about three times on public health and more than twice as much on other beneficent activities.[2] It is not necessary to make any comments. The facts speak for themselves. The inadequacy of public expenditure in Bihar and Orissa is obvious, and it is unthinkable that this Province should be doomed to stagnation while the other Provinces and the country as a whole are going ahead ; but that is the only way in which its future can be envisaged if there is no substantial improvement in its present financial position.

This gloomy outlook is, of course, due to the inelasticity of the resources of this Province. Its total revenue has increased from Rs. 4·43 crores in 1921–22 to Rs. 5·74 crores in 1928–29.[3] This increase is mainly due to the growth of revenue from stamps and excise. Revenue from stamps has increased from Rs. 58 lacs in 1921–22 to Rs. 1·05 crores in 1927–28, and excise revenue from Rs. 1·23 crores to 1·90 crores. There has also been an increase of revenue under the other heads, but that is not considerable. Revenue from stamps and excise

[1] Table XXXI.
[2] Table XXVII.
[3] Table XXV.

cannot be expected to go up much higher. Excise revenue has, after reaching the highest point in 1927–28, been stationary for the last two years with a slight downward tendency. Stamps revenue also seems to have attained a position of stable equilibrium, and is not growing. The Permanent Settlement makes it impossible to obtain an expanding revenue from the taxation of land, and other sources of revenue do not possess any capacity for growth. The Province as is well known, is the richest Province in the country in respect of mineral resources; but the public right over them has already been alienated by the declaration of Lord Cranbrook, the then Secretary of State for India, in 1880, that, even if the legal right to minerals in permanently settled estates could be established, it would not be desirable to enforce it. The Province has, by this ill-advised decision, been reduced to a position of utter helplessness, and a right which could have been used to increase its fiscal resources has thereby been given away on account of an undue regard for vested interests. The position, to repeat once more, is almost desperate. The Finance Member of Bihar and Orissa in his last Budget speech spoke of 'the bleak poverty' of the Province, and the imperative necessity of securing 'better terms and much better terms' under the new financial settlement. That Bihar and Orissa has not been fairly treated in the past cannot admit of any doubt; and that it is, on that account, entitled to special consideration, must also receive general assent if we take a really national view of the question. But it can vindicate its right to get 'much better terms' only by its willingness to cultivate the qualities of self-help and self-reliance to a much larger extent. This is, however, a line of argument which will have to be developed at some length in a later chapter. It is not necessary to anticipate it here. This brief review of the financial position of Bihar and Orissa during this period shows that, in spite of the balanced budgets and the growth of revenue and expenditure under some principal heads, the Province is still in an undeveloped condition, and special efforts will have to be made to accelerate the pace of its progress in all spheres of administration.

*Punjab*

The Province, which comes next in size of population, is the Punjab. Under the Meston Settlement, it has enjoyed a period of financial prosperity; and its revenues have, as anticipated by the Meston Committee, moved upwards with marked ease. Its revenue and expenditure have risen from Rs. 7·1 crores and Rs. 8·81 crores, respectively, in 1921–22 to Rs. 12·73 crores and Rs. 12·77 crores in 1928–29.[1] It passed through a period of revenue deficits in the first two years after the introduction of the Reforms; but since 1923–24 the upward tendency of its revenues has asserted itself, and its revenue surpluses from 1923–24 to 1925–26 amounted to over Rs. 4·5 crores. There has been an increase in its expenditure [2] on all heads except police, on which there has been a slight decrease. The increase on general administration from 1921–22 to 1927–28 amounts to Rs. 13·32 lacs, on law and justice to Rs. 11·83 lacs, on education to Rs. 66·97 lacs, on medical services to Rs. 25·65 lacs, and on other beneficent departments to Rs. 25·14 lacs. This pace has been kept up since then; and from the details given by the Finance Member of the Province in his Budget speech of 1929, it appears that the allotment on education has increased since 1926–27 by 21 per cent, on medical services by 33⅓ per cent, on public health by 19 per cent, on agriculture by 34 per cent and on industries by more than 50 per cent. This is a remarkable expansion of expenditure, and has been accompanied by an all-round progress of the Province. It has also been in a position to provide large funds for capital expenditure out of its revenue. In 1927–28 and 1928–29 the capital expenditure, financed from revenue, amounted to about Rs. 2·60 crores. It has also made a beginning in building up a Revenue Reserve Fund, and large sums have been credited to it to provide a stand-by for the lean years. Its relative position in the scale of expenditure has been considerably improved during this period, and it compares favourably

[1] Table XXV.     [2] Table XXXII.

with all the Provinces except Bombay and Burma. The Punjab cannot possibly have any grievance against the present financial settlement in view of this general improvement in its position.

There has been an increase of receipts from all the main sources of revenue.[1] Land revenue, including the receipts from irrigation credited to this head, has risen from Rs. 3·79 crores in 1921–22 to Rs. 4·9 crores in 1927–28, and irrigation receipts proper from Rs. 1·74 crores to Rs. 2·57 crores during the same period. That means that land revenue and irrigation, taken together, account for an increase of over Rs. 2 crores. Revenue from stamps has risen from Rs. 81 lacs to Rs. 1·14 crores, and has thereby contributed Rs. 33 lacs to the growth of the Provincial revenue. In 1927–28 there was a temporary set-back in the receipts from excise, but there was steady increase in the excise revenue from 1921–22 to 1926–27, and the receipts rose from Rs. 1·08 crores to Rs. 1·24 crores. The Province has also been realizing very large amounts by the sale of land, and the total amount credited to this head till 1926–27 amounted to Rs. 5·49 crores. The remission of the Provincial contribution has, of course, increased its resources, and placed at its disposal an additional spending power of Rs. 1·75 crores. In irrigation this Province has a very valuable asset, which has great fiscal possibilities. Water-rates do not, according to the Irrigation officers of this Province, truly represent the obligation which should be imposed on the classes benefited by the provision of irrigation facilities made at the expense of the general tax-payer, and ought to be considerably raised. The tendency now at work is the other way; and already this Province has sacrificed an annual revenue of Rs. 25 lacs on account of the lowering, as a result of the pressure of the rural parties in the Provincial Legislature, of the occupiers' rates in 1925–26. But if the standard of civic ethics can be raised to a higher level, this Province can very well expect to expand its revenue still further by the revision of

[1] Table XXXII.

its water-rates; and with the completion of the Sutlej Valley project and the hydro-electric scheme, its non-tax revenue should, in due course, provide still larger funds for the development of the Province. The fiscal future of this Province is, therefore, very reassuring in every respect, and now that it is in a position to choose between the development of services and the remission of taxation it can, by making the right choice, consolidate the position that it has won for itself, and become one of the most progressive Provinces of India.

*Bombay*

The equity of the Meston Settlement was questioned by Bombay before its introduction, and it has since then been persistently criticized by the Government and the people of the Province. Bombay had, like other Provinces, a heavy revenue deficit in the first year of the Reforms; and then, after having balanced budgets for three years and realizing a total surplus of Rs. 1·20 crores, it has, since 1925–26, been having recurring deficits, and the future outlook is distinctly depressing. This unhappy result, is, in no small measure, due to the misadventures of this Province in its handling of what is known as the Bombay Development Scheme, which has proved to be an exceedingly bad business investment and has thrown an annual interest charge of Rs. 66·11 lacs on the Provincial revenues; and a sum of Rs. 95·16 lacs has had to be provided every year since 1921–22 for the sinking fund of the loan. The loss, which the Province has had to suffer, has nothing to do with the financial settlement, though it has hit it hard, and cannot be taken into account in evaluating the actual results of the Meston Award. There has been practically no increase of expenditure[1] on any service except education, the expenditure on which shows an increase of about Rs. 33 lacs. The apparent increase of the expenditure on general administration is mainly due to the re-classification of expenditure and not to its growth. There is an actual

[1] Table XXXIII.

decrease of expenditure on police, law and justice and even medical services and public health. In spite of this arrested progress of expenditure, Bombay still retains its position of eminence as a spending Province, and its scale of expenditure in 1927–28[1] is, as it has been since 1876–77, far above the Indian average. On education its expenditure per 1,000 of population is more than double that of every other Province except Burma and the Punjab; on medical services and public health, its expenditure is higher than that of all other Provinces except Burma; and on the other beneficent departments, the only Province which can claim priority over it is the Punjab. Its expenditure on police, law and justice and general administration, in spite of the retrenchment of the Reforms period, is far in excess of that of the other Provinces, the only exception being Burma, whose expenditure on police and law and justice is higher than that of Bombay. It is neither practicable nor desirable to ask Bombay to reduce its expenditure for the benefit of the other Provinces. It cannot even be expected to stand still till the other Provinces come up to its level. But the fact that it is in advance of the other Provinces is an important consideration in itself; and their needs must naturally have precedence over its needs when there is a question of providing for Provincial development at the expense of the Central revenues. Bombay has, in the new financial settlement, to be placed in possession of funds to meet its growing expenditure. That, however, cannot be done by an arrangement which involves a sacrifice of the income of the Central Government, when the less fortunate Provinces like Bihar and Orissa and Bengal, are in such financial straits. In 1919 the Meston Committee expressed an opinion that Bombay could without inconvenience forgo the greater part of its new resources, and help the other Provinces out of its balances. Its balances have been reduced to a very low figure, having fallen from Rs. 306 lacs in the beginning of 1921–22 to Rs. 7 lacs at the end of 1928–29, and its new resources have not been sufficient even to meet its own expenditure. Now Bombay has to

[1] Table XXVII.

find new resources for itself; and its high scale of expenditure carries with it an obligation to rely to a greater extent than other Provinces upon its own efforts for enlarging its resources.

The revenues of Bombay, in the opinion of the Meston Committee, had a pace of expansion distinctly higher than in any other Province. They based their view on the fact that from 1912–13 to 1919–20 the revenue from excise had grown in Bombay by 102·57 per cent, from stamps by 119·13 per cent, from land revenue and other sources by 32 per cent, and from all Provincial heads taken together by 52 per cent. This pace of expansion has, however, not been maintained during this period.[1] It would appear that from 1921–22 to 1927–28, the Provincial receipts from land revenue have decreased by Rs. 73 lacs; and from stamps and excise they have increased by Rs. 22 lacs and Rs. 67 lacs respectively. From the scheduled taxes Bombay is getting about Rs. 23 lacs a year, which is an addition to its resources; and Bombay has, of course, gained Rs. 56 lacs by the remission of contributions. This means that Provincial revenues in Bombay have gone up by about Rs. 1·58 crores, of which the growth of its tax-revenue accounts for only about Rs. 92 lacs. These are the principal sources of revenue, and they have not shown the same buoyancy after 1921–22 as they did before that year; and it is not likely that their receipts will grow rapidly in future. Land revenue, excise, and stamps yield more than 95 per cent of the total tax-revenue of Bombay, and as the incidence of these taxes per head of population is, leaving aside Burma, the highest in India, they cannot be expected to provide much margin for development. The situation is certainly, therefore, disquieting in Bombay. Its scale of expenditure is high, but it has been practically stationary in recent years. Its resources are also large, but they too have not been growing of late, and there is no reason to believe that they will pick up their rate of growth in the immediate future. With inexpansive resources and expanding expenditure, the Province cannot help feeling that its financial condi-

[1] Table XXXIII.

tion is acute; and the prospect of stagnation even at a high level of development is sure to cause a serious revulsion of sentiment. The insistence of Bombay that nothing short of a thorough revision of the Meston Settlement will meet the requirements of the case is, therefore, easily intelligible, and, viewed in the light of these facts, entitled to a sympathetic consideration.

## *Central Provinces*

In the first year after the introduction of the Reforms the accounts of the Central Provinces showed a deficit, which was met out of its balances. In the following four years the Government secured an equilibrium of revenue and expenditure by imposing additional taxation and reducing expenditure. But the two Taxation Acts, passed by the first Council, expired on the 31st March 1926; and in 1926–27 the Province had again a revenue deficit of Rs. 67 lacs. With the remission of the Provincial contribution of Rs. 22 lacs, the position has again improved, though the margin between revenue and expenditure is very narrow, and any mishap is likely to upset the equilibrium. Revenue and expenditure have increased from Rs. 4·72 crores and Rs. 4·95 crores, respectively, in 1921–22 to Rs. 5·54 crores and Rs. 5·68 crores in 1928–29.[1] The expenditure on general administration has increased by Rs. 17 lacs from 1921–22 to 1927–28,[2] on law and justice by Rs. 1 lac, on police by Rs. 3 lacs, on education by Rs. 10 lacs, on medical services by Rs. 2 lacs and on other beneficent departments by Rs. 5 lacs. The scale of expenditure[3] in the Province is low, though it compares favourably with that of Bihar and Orissa and the United Provinces. The Central Provinces has also to be considered a backward Province; and the need of supplementing its resources in order to provide funds for development must receive due attention in the general re-adjustments of the future.

Excise has been the most elastic source of revenue in the Central Provinces during this period, and its yield

[1] Table XXV. [2] Table XXXIV. [3] Table XXVII.

has increased from Rs. 1·05 crores in 1921–22 to Rs. 1·47 crores in 1927–28 ; and according to the statement of the Finance Member of the Province, made by him in his last Budget speech, a normal annual increment of Rs. 8 or 9 lacs in the Provincial revenues from this source may be expected. Income from land revenue has been actually decreasing from 1921–22 to 1927–28 ; and its yield was Rs. 2·50 crores in the latter year, as compared with Rs. 2·65 crores in the former. Revenue from forests has increased by Rs. 8 lacs and from stamps by Rs. 12 lacs ; but irrigation revenue is a minus quantity in the finances of this Province. The bulk of its revenue is derived from land revenue and excise ; and as the former is slow to expand, excise is the only source of revenue which is capable of some expansion. If it is considered wrong to depend upon this 'tainted money' for carrying on and developing the administration of the Province, it must find new sources of revenue to keep pace with its expanding expenditure. What those new sources should be is the problem of the Central Provinces, as it is of the other Provinces and of the country as a whole.

### *Burma*

The financial position of Burma is very peculiar. With a population slightly less than that of the Central Provinces, it stands first in point of area. Its total revenue and expenditure in proportion to its population are the highest in India, and its expenditure on different services, with one or two exceptions, is higher even than that of Bombay, and still it is contended on its behalf that Burma is far behind India proper in what its Government does for its people. The total revenue and expenditure have risen from Rs. 9·18 crores and Rs. 9·04 crores, respectively, in 1921–22[1] to Rs. 10·73 crores and Rs. 11·78 crores in 1928–29. The Province has had deficits for seven years in succession since 1922–23, which have been met out of the huge opening balance of

[1] Table XXV.

Rs. 5·72 crores. It has been spending very large amounts on buildings and communications, which have had to be constructed on account of the vastness of its area and its undeveloped condition. It has had at its disposal very large receipts realized before the Reforms from the system of rice control, which it has utilized subsequently for capital expenditure. The opening balance to the credit of this account amounted to Rs. 8·87 crores, which was drawn upon from 1923-24 to 1926-27 to the extent of over 6 crores till the end of 1926-27. This made it possible for the Government of Burma to do without borrowing till 1927-28 in spite of its heavy non-recurring capital expenditure. The expenditure on general administration increased from 1921-22 to 1927-28 by Rs. 24 lacs, on law and justice by Rs. 32 lacs, on police by Rs. 2 lacs, on education by Rs. 53 lacs, on medical services and public health by Rs. 30 lacs, and on the other beneficent departments by Rs. 10 lacs.[1] The recurring deficits, it is clear, are not due to the deficiency of revenues, but are an index of the enterprise of the Provincial Government in developing its administration. The case of Burma is not on all fours with that of the other Provinces on account of the fact that, racially and geographically, it is not a part of India proper, and the conditions here cannot be compared with those prevailing in other parts of the country. The demand for separation from India has, of late, been growing more and more insistent, and it is not easy to refute the arguments by which it is supported. Even if the new constitution does not satisfy this demand, the fact that the union of Burma and India is to be continued merely as a matter of expediency or administrative convenience will necessitate a special treatment of the whole question of financial re-adjustment between them. The Accountant-General and the Auditor-General have, for some years past, been taking a pessimistic view of Burma's finances; but if it does not embark upon very ambitious projects of expenditure, its financial position need not be viewed with any misgivings.

[1] Table XXXV.

Land revenue receipts in 1927–28 were practically the same as those in 1921–22,[1] the difference of 5 lacs being due to ordinary contingent variations. Income from excise and stamps has gone up from 1921–22 to 1927–28 by about Rs. 24 and 20 lacs respectively. The increase of income from forests is not large ; but if we take into account also the decrease of expenditure, the net increase amounts to about Rs. 21 lacs. Burma has also gained by the operation of Devolution Rule 15,[2] but that is due to a circumstance which is purely fortuitous. Under this rule, the year 1920–21 is adopted as the basic year for the calculation of the Provincial share of income-tax receipts, and as till very recently there did not exist any properly organized machinery for the assessment of income-tax outside Rangoon City, the extension of the activities of the income-tax department has led to an increase of assessed income and therefore to a proportionate increase of the assignments to Burma under this rule. In 1927-28 Burma's assignment was Rs. 15·00 lacs, as compared with Rs. 3·85 lacs in 1921–22. The remission of the Provincial contribution has increased Burma's resources by Rs. 64 lacs. In forests this Province has a valuable public estate which can be further developed. It is already getting more from this source than any three other Provinces put together, and with proper management it should be able to get much more. More than 67 per cent of its vast area is under forests, and though a very large part of it consists of inaccessible and undeveloped hill tracts, it cannot be assumed that the point of maximum revenue has been reached.[3] Burma's complaint is that the Central Government is taking from it an unduly large share of its total revenues. With a population not more than one-twentieth of that of British India, it is contributing not less than one-tenth of the receipts of the Central Government, and as there can be no question of the locale and incidence of revenue

[1] Table XXXV. [2] Table XXXVII.

[3] The net receipts from forests in Burma have already increased from Rs. 53·64 lacs in 1899–1900 to Rs. 1·46 crores in 1926–27, and it should be possible to count upon their further expansion in the future.

collected in Burma being different, it is possible to argue that it has to pay very heavily for union with a country with which it has otherwise so very little in common. It is extremely difficult to allocate to Burma and the other Provinces their share of the Central expenditure ; but as Burma is an organic unit in itself, and the separation from India will cause it no wrench, it is not likely to attach to the needs of the Central Government their due weight and importance. The need for special treatment emphasized in the preceding paragraph is re-inforced by these considerations. The problem of federal finance in relation to Burma has a special aspect of its own. There is no strong desire for unity on either side ; and it is not easy to devise an arrangement which will be accepted as equitable by the less willing partner. The position obviously needs careful handling.

### *Assam*

Assam passed through two years of revenue deficits after the introduction of the Reforms, but since 1923–24 it has been having balanced budgets and realizing small surpluses. Its revenue has increased from Rs. 1·82 crores in 1921–22 to Rs. 2·78 crores in 1928–29, and its expenditure from Rs. 2·05 crores to 2·82 crores.[1] The expenditure on general administration has increased from 1921–22 to 1927–28 by Rs. 3 lacs, on law and justice by Rs. 2 lacs, on police by 1 lac, on education by Rs. 5 lacs, on medical services by Rs. 8 lacs and on other beneficent departments by Rs. 2 lacs.[2] Its scale of expenditure is one of the lowest in India, being only a little higher than that of Bihar and Orissa.

There has been an increase of receipts from 1921–22 to 1927–28 from all sources of revenue. The increase of income from land revenue amounts to Rs. 17 lacs and from excise to Rs. 11 lacs. A very large proportion of its area, like that of Burma, is under forests; and it can be developed and made a source of growing revenues for the Provincial exchequer. The working of the Devolution Rule 15 has

[1] Table XXV.

[2] Table XXXVI.

also specially favoured Assam, and its assignment under this rule has increased from Rs. 0·02 lacs in 1921–22 to 6·00 in 1927–28.[1] This is due again to an accidental circumstance, and has not been accompanied by any marked expansion of assessable income. The income of tea companies in Assam forms the major portion of the assessed income in this Province; and as these companies were assessed to income-tax after 1920–21, it has been receiving large assignments under the rule. The revenues of Assam, in spite of an increase of 41·1F per cent since 1921–22, are inadequate for its needs, and it requires much larger resources to attain a higher level of development. It has to be helped to come into line with the more advanced Provinces.

The Meston Settlement may now be reviewed as a whole. It has very few friends. Sir Basil Blackett has defended it against its adversaries on a number of occasions, and expressed the view that what is required is the amendment of the Meston Settlement, rather than a fresh deal. But this view is not shared by the Finance Members of the various Provinces, and they have declared themselves in favour of its revision and the redistribution of revenues. There is, as already stated, in the Provinces, a unanimity of opinion among officials and non-officials on this point, which is as significant as it is rare; and they are vying with each other in expressing their strong disapproval of the existing financial arrangements. The Finance Member of Bengal concluded his Budget speech of 1929 by referring to the manner in which the Government had put the case of Bengal before the Statutory Commission, and said: 'We presented a united front, and feel convinced that we impressed the members of the Commission that we have a strong case. We can only wait for the result of their deliberations and hope for the best.' This policy of presenting 'a united front' has also been followed by the other Provinces, and the Commission must have been impressed not only by the fact that some Provinces had a strong case for revision, but also that they were all

[1] Table XXXVII.

dominated by purely Provincial considerations, and were apt in their zeal to make out a good case for themselves, to emphasize their rights more than their duties. Each Province has, of course, to speak for itself, and knows best the hardships which it has had to suffer under the present financial settlement; but the problem of federal finance cannot be solved without taking an all-India view of the matter, while at the same time the case of each Province is important, inasmuch as equity to all must be an essential feature of its solution.

Now let us see what is wrong with the Meston Settlement. The grievance that the Provincial contributions to the Central Government, fixed by the Meston Committee, were not equitable as between the different Provinces need not be considered. The abolition of the contributions being a settled fact, the grievance has now only a historical interest; and its only bearing on the present problem is that its redress has, in some cases, increased the inequalities in the allocation of resources. As that aspect of the question has already received sufficient attention, and is still to receive much more, it can be overlooked here. The contributions are a matter of the past now, and the other defects of the Settlement are of much greater practical importance.

There is another defect of the Settlement, which, in spite of the prominence which has been given to it by Bombay, is really a minor defect, and may be soon disposed of. The authors of the Reforms and the Meston Committee were, as will be easily remembered, against the provincialization of income-tax, and their view was strongly endorsed by the Joint Select Committee. But the latter assigned to the Provinces a share of the increase in the receipts of income-tax, due to the increase of the assessable income, to alleviate the disappointment of Bombay and Bengal. The actual results of the operation of Devolution Rule 15, in which this recommendation was inserted, show that, judged from the point of view of the Provinces, and especially of Bombay and Bengal, it has been a failure.[1] The only two Provinces which have

[1] Table XXXVII.

received comparatively large amounts as their assignments under this rule are Burma and Assam; but that, as already stated, is due to their good luck on account of the changes of the income-tax law, and is not in accordance with the general intention of the rule. The failure of the rule is due to the adoption of the year 1920-21 as the basic year, and its results would have been different if a different datum line had been taken. The Government of Bombay have, as a matter of fact, advocated a change in the datum line for the calculation of the Provincial share of income-tax receipts. The defect is there; but since the assignment of a share of the revenue from this source was never regarded as an integral part of the Meston Settlement, it is not necessary to dwell upon it at greater length. Its failure has been a source of disappointment to the industrial and commercial Provinces, but that cannot be urged as a reason for condemning the settlement itself.

This brings us to the three most important defects of the Meston Settlement. They have already been referred to again and again in the course of the arguments of this and the preceding chapter, but now have to be stated specifically. One defect, with regard to the existence of which there can be no difference of opinion, is that the revenues of the Provinces, with one or two exceptions, are utterly lacking in buoyancy. It is generally admitted that the functions assigned to the Provinces under the present constitution, and those with which they are likely to be charged under the new constitution, require that their resources should be capable of considerable expansion in order to keep pace with their growing expenditure. The real trouble now is that, while the pressure of demand for increased expenditure falls on them, the most elastic and expanding sources of revenue are reserved to the Central Government. Financially the Central Government has done well since the introduction of the Reforms. They have remitted the Provincial contributions of Rs. 9·83 crores, the cotton excise duty, reduced the salt-tax and the export duty on hides and tea and the import duty on cars (the total loss of revenue by the remission and reduction of taxation

amounting to about Rs. 6 crores), reduced railway rates and fares, built up the Railway Depreciation and Reserve Funds, reduced the unproductive debt by Rs. 72 crores, financed heavy capital expenditure without having recourse to loans in several years, and made a liberal provision for the redemption of debt, both productive and unproductive. These are remarkable achievements, but they have been made possible more by the reduction of expenditure and better financial administration than by the growth of revenue. There has been increase of Rs. 9 crores in the receipts from customs, but the other important sources of revenue, viz. the income-tax and the salt-tax, have not shown any marked capacity for expansion. The salt revenue cannot grow rapidly without an enhancement of the rate; and the income-tax receipts have not been increasing on account of the trade depression, though they are now showing some signs of an upward movement. Since 1921–22 Provincial revenues as a whole increased more rapidly than Central revenues, and there has been considerable growth of Provincial expenditure. But the outlook for the Provinces is gloomy when we look ahead, and take a forecast of their resources and requirements. They have to face the prospect of being called upon to meet the demands for increasing expenditure, which cannot possibly be met without the re-allocation of resources. Their principal heads of revenue are all inelastic. In the permanently settled areas the yield of land revenue has been and will remain almost fixed. The conditions in other Provinces are rapidly approximating to what we may call a state of quasi-permanent settlement. We have believed so long in the Permanent Settlement as the specific for our agricultural ills, that even though our enthusiasm for it has recently been on the wane, the habit of mind generated by long association of ideas still persists and is efficacious enough to become the cause of the increasing rigidity of what is and has to be the mainstay of Provincial finance.

It is extremely short-sighted to allow ourselves to move in the rut which we have made for ourselves. We shall thereby stereotype the anomalies and contradictions of our existing system of land taxation, and make the

task of the fiscal reformers even more difficult in the future than it is to-day. The tendency which is at work is to be deplored, but one cannot expect that it will be revised without inviting the charge of being absolutely out of touch with the facts of the case. There is, therefore, no prospect of any change in this respect, and land revenue is and will remain an inelastic source of revenue. From 1921–22 income from excise duties has increased by about Rs. 2 crores ; but though it may be possible to raise a larger revenue in those Provinces where the incidence of excise duties is low, their income on the whole is not likely to grow owing to the fact that excise rates have already been raised to a high level, and violation of the excise law has consequently increased. Prohibition will remain a distant ideal for years to come ; and as the practical difficulties of enforcing it are more clearly appreciated, the people will learn to take a more matter-of-fact view of the question. But even so excise revenue is likely to decrease rather than increase, and restrictive measures will be applied with greater rigour. Excise is, therefore, to be looked upon as a liability and not an asset of our fiscal system, and it will give to the latter an inverted elasticity which will make the necessity of finding compensating factors more imperative than ever. Provincial revenue from stamps has increased by about Rs. 2·5 crores, but that is mainly due to the revision of fees, judicial and non-judicial, and it is not possible to enhance them much further. Stamps revenue has been stationary since 1924–25, and its growth in the future will not import into Provincial revenues the elasticity which they need so urgently. Irrigation and forests will yield growing revenues in some Provinces ; but receipts from these sources can grow only if large outlay is incurred for capital expenditure, and even then it will take some time before its full benefits can be realized. The factors which led to the increase of Provincial revenues after 1921–22 seem to have spent their force in 1925–26, for Provincial revenues have not increased since that year. The present allocation of resources between the Central and Provincial Governments is open to serious criticism on the ground that the actual and

potential sources of revenue allotted to the latter are inelastic and their receipts will be quite inadequate for their requirements. Revenue from customs and income-tax will expand with the recovery of trade, internal and external, and the expenditure of the Central Government will and should decrease unless there is another war and the conditions are abnormal. The Central Government will thus have a surplus which ought to be available for the development of the country. The Provinces, on the other hand, will need funds which they will not be able to get from their existing resources, and it is only a matter of putting two and two together to conclude that the Central Government ought to give and the Provincial Governments ought to receive the funds which are now at the disposal of the former. That in itself, however, will not do; and the necessity of imposing additional taxation cannot thereby be obviated, for the amount of money which the country needs for development is almost unlimited. But we have to make the most of our resources, and it is necessary that the Provinces should get some relief at the expense of the Central Government. The *modus operandi* of this transfer will have to be devised, and carefully considered. But what is to be done is clear, and the rest is a matter of detail.

Another defect of the Meston Settlement is that it leaves the Provinces with very unequal resources, and thus continues the disparity in their financial strength which has existed since 1871–72. The inequalities are due to historical factors: but as the past cannot be wiped out at once, they have to be taken into account. The authors of the Reforms and the Meston Report knew that they were there, but expected that they would be smoothed out by the extinction of Provincial contributions and the growth of Provincial revenues. But that has not happened, and the disparity of revenue and expenditure is now even more striking than it was after the introduction of the Reforms. It was in 1897 that Mr. Gokhale pointed out the existence of these inequalities, and said that it was high time that they should be rectified. But nothing was done then, and nothing has been done since to remove them. The advice, which was not taken thirty-three

## TABLE XXVI (a)

Statement showing expenditure in the different Provinces on certain selected services in 1921–22 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|
| Bombay ... ... | 263 | 173 | 240 | 346 | 238 |
| Central Provinces ... | 143 | 97 | 98 | 130 | 76 |
| Madras ... ... ... | 132 | 96 | 116 | 131 | 138 |
| Punjab ... ... ... | 175 | 127 | 135 | 166 | 126 |
| United Provinces ... ... | 125 | 74 | 97 | 129 | 69 |
| Bengal ... ... ... | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... ... | 139 | 52 | 73 | 120 | 133 |
| Burma ... ... ... | 264 | 164 | 271 | 172 | 179 |
| Bihar and Orissa ... | 84 | 48 | 57 | 61 | 36 |

years ago, has now to be acted upon. It will not do to say that, if Provincial autonomy is to come and to be a reality, the Provinces must face the task of raising their own taxation. This consideration is important, and has determined the allocation of resources under the Reforms. But the inequalities are so glaring, and have such serious reactions on our whole political life, that it is not possible to proceed on the assumption that each Province must now cut its coat according to its cloth. The Government of India cannot disown responsibility for their existence. In the successive settlements till 1920–21, which were, as has been stated so often, based on needs, the Government of India either ignored or denied their existence, and allowed the factors, which aggravated them, to have free play. In 1921–22 they made an entirely new departure, and changed the basis of the financial settlement from needs to revenue with a view to ensure the fiscal independence of the Provinces, and relied upon their undemonstrated faith in the future for the rectification of inequalities. This was, to say the least, extremely unfair. For over fifty years the Government of India blundered on in the distribution of revenues which, as was pointed out again and again, formed one consolidated fund, and were to be applied to the purposes of the Government of India as a whole; and in 1920, finding that they had created a tangled problem for themselves, they sought to solve it by laying down the maxim of the fiscal independence of the Provinces, and leaving them to their own devices.[1]

[1] It is not quite correct to say that the Government of India escaped from the consequences of their policy by cutting the knot when they could not untie it. The doctrine of the 'clean cut' was first propounded in the Joint Report, and received the approval of the Joint Committee and Parliament. But the Government of India also endorsed it, and did not point out the need of making a transition from the old system to the new gradually, and with due regard to the disparity in the financial strength of the Provinces, except in the matter of the Provincial contributions. They, however, had never shown special solicitude for the welfare of the Provinces, which needed special assistance; and it was not surprising that they did not stand by them at the time of the new financial settlement. They had been always for letting sleeping dogs lie, and they did not depart from their old policy in 1920.

## TABLE XXVII (*a*)

Statement showing expenditure in the different Provinces on certain selected services in 1927–28 per 1,000 of population, supposing the Bengal expenditure to be 100.

| Provinces | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|
| Bombay ... ... | 411 | 159 | 209 | 345 | 141 |
| Central Provinces ... ... | 169 | 95 | 163 | 131 | 53 |
| Madras ... ... | 193 | 95 | 107 | 166 | 98 |
| Punjab ... ... | 190 | 138 | 128 | 199 | 126 |
| United Provinces ... ... | 103 | 73 | 83 | 123 | 51 |
| Bengal ... ... | 100 | 100 | 100 | 100 | 100 |
| Assam ... ... | 136 | 58 | 77 | 120 | 121 |
| Burma ... ... | 292 | 233 | 275 | 276 | 201 |
| Bihar and Orissa ... ... | 75 | 55 | 59 | 83 | 51 |

Provincial autonomy is and must remain the *sine qua non* of all political progress in India. Such independence as the Provinces have already achieved has to be conserved, and a larger measure of independence secured for them under the new constitution. But the Government of India cannot ignore the irreducible and stubborn facts, and assume that each Province can now rise to the level of others by self-help and enterprise, when all the realities point to the necessity of a well-considered and concerted action for the removal of these inequalities. Here again the problem is difficult, and has to be carefully thought out. Provincial autonomy is the foundation on which our whole political system is to rest. Nothing must be done to impair or weaken it, though the needs of co-ordination and national integrity are also paramount and have to be provided for. Financial autonomy is essential for political autonomy, and has to be duly ensured. The task of levelling up has to be undertaken without undermining the position of the Provinces as self-governing units of the national Commonwealth. The misgivings of those who are keenly alive to the dangers of retarding the political progress of the country by making the Central Government again a predominant partner in its financial business are based on past experience, and have to be allayed. The problem is how the re-adjustments necessary for rectifying inequalities can be made without making the Central Government supreme in the administration of Provincial finances. Inequalities, due to the mistakes of the past, must be taken as a liability which has to be liquidated and made a charge on the national revenues; and this has to be done without placing the Provinces under the financial tutelage of the Government of India. The problem, to repeat ourselves once more, is difficult, but has to be faced. It cannot solve itself. The flux of time, to which so much is left, has already made it acute. It cannot be shelved any longer.

Both these defects have arisen out of the third, which is still more fundamental. The doctrine of the 'clean cut', which has been the most important limiting factor in the whole settlement, was first laid down in the Joint

Report, but has since then been so generally endorsed that it has become an article of faith with all who stand by the present constitution and its premises. This doctrine, as understood and applied in India, is a false doctrine, and must be discarded. In the allocation of resources, as pointed out already, the decisive factor was administrative convenience. Each Government was assigned the sources which it could administer efficiently and independently, and was to appropriate the yield of those sources for its own purposes. It was assumed that the sources so assigned would provide adequate revenues for the needs of the Governments concerned and satisfy the considerations of equity. It is not at all surprising that this anticipation has not come true, as there is nothing in the nature of things to ensure that the income of taxes, which each political authority can or ought to undertake to administer, will be adequate and no more than adequate for its requirements. On account of the broadening basis of the assessment and administration of taxes, it is becoming increasingly desirable to put the Central Government in charge of a number of direct and indirect taxes; and it is, of course, out of the question to reserve their entire income for the discharge of the functions for which the Central Government is made responsible. It is not at all possible to ensure a correspondence between the considerations of adequacy and administrative convenience. It is because in the Meston Settlement this obvious fact was lost sight of that the Provinces were left with inelastic sources of revenue, and the disparity in their financial strength was so completely overlooked. It is important that the administrative responsibility of the several taxes should rest on the Government which is in a position to discharge it well; but it does not follow that it should use the proceeds of those taxes exclusively for its own needs, or depend upon them only for carrying on its administration. Dr. Albert Hensel distinguishes between what he calls 'object sovereignty' and 'produce sovereignty' of taxes. By the former he means the exclusive right to impose a tax, and by the latter a similar right to utilize its income. The doctrine of the 'clean cut' takes it for granted that both these

rights should be vested in the same authority, but their combination is neither necessary nor practicable. It is at variance with the facts of economic life, and disregards the vital needs of the body politic. In the new financial settlement it is necessary to shake off the obsession of 'securing a genuine and complete separation of resources'. Such a separation, as will be clear from the contents of the next chapter, does not exist anywhere in the world, and it is not possible to devise a settlement suited to our own special needs if we are to be bound by this doctrine of segregation of resources.

# CHAPTER V

## *The Financial Settlements in Federal States*

This book, as stated in Chapter I, has been written on the assumption that the Indian constitution in its functional aspect is to be federal in its essential character. The process in India, it is true, is the reverse of what has taken place in other federal states, but that will not make any difference so far as the actual working of our political system is concerned except that it will be possible to implement therein the essential principles of federal finance more systematically on account of the absence of inherent political rights in the Provinces. Decentralization, as already remarked, is a measure of federation, and carried far enough will give us a constitution essentially similar to the constitutions of other federal states. A study of the financial systems of the federal countries of the world cannot therefore but be of great interest for the solution of the problem of financial re-adjustments between the Central and Provincial Governments in India.

In almost all federal states the question of fiscal relations between the federal governments and their constituent states has of late assumed very great importance owing to a radical change in the basis of their entire economic life and to a lack of adjustment between the needs and resources of these federations and their component parts. A great deal of attention is being given to it in the United States of America, Switzerland, Germany and the self-governing dominions of the British Empire; and it is being felt necessary to adopt measures for the harmonization of taxation and for better adjustment between the expenditure and revenue of the different political authorities. The question having come to the fore on account of the increasing integration of economic life and the enlargement of the functions of governments,

it is not easy to find expedients which, while reconciling the conflicting claims of administrative efficiency and adequacy of revenues, will fit in with the facts of political and economic life. The defects of the old systems of federal taxation enable us to understand the difficulties of introducing the necessary improvements, and it will take time before the fiscal inter-relations of these authorities are stabilized. The problem in India has special features of its own; but, in the words of Sir Basil Blackett, 'there is much to be learnt from the failures and the successes in the direction of federal finance of existing federal governments,'[1] and it is worth while to know and understand the position in other countries in order to make whatever use we can of the lessons of their experience. Limitations of space make it necessary to deal with this aspect of the subject very briefly, but still it should be possible to get some idea of the salient features of the systems of federal finance in other countries.

## *United States*

The United States of America is the oldest federal state, its constitution has served as a model for other countries, and the spirit of its constitution has exercised a great influence over the development of all federal constitutions. The distinctive characteristic of the American constitution is, as is well known, its rigidity. The constitution of 1789 is still in operation. Its practical working has undergone a change on account of the development of a well-organized party-system, enunciation of the doctrine of 'implied powers', and the immense influence acquired by High Finance, which has suggested to Bertrand Russell the Aristotelean conception of 'the unmoved mover', of the ruler at rest in the centre while all else revolves round him at varying rates. But there have been very few formal changes in the framework of the constitution and of them only one is of significance from the standpoint of federal finance. As the problem of the

[1] Speech in the Legislative Assembly, 18 September 1924.

relation of federal and state finance hardly existed in Hamilton's time, on account of the fiscal needs of the States being practically non-existent, at the outset 'the Federal Government was not', to quote Seligman, 'seriously embarrassed in the choice of revenue by any consideration affecting state finance.' In spite of the fact that the functions assigned to the Federal Government were few and limited, the only restriction imposed upon its financial power was that the direct taxes levied by it had to be apportioned according to the population of the States; and as now even that restriction has been removed, the range of financial powers of the Union is virtually unlimited. The Federal Government can levy any tax, direct or indirect, and determine its principles and rates according to its own lights and requirements. In the meanwhile, the fiscal situation of the States has entirely changed, and since the American Civil War they also have felt the impact of the forces which have everywhere necessitated the extension of governmental functions and therefore the expansion of expenditure. And as they too are not precluded from imposing any taxes whatsoever except import and export duties (the imposition of the latter was also forbidden to the Federal Government), their fiscal powers are very wide, and they have in practice used them to raise their revenues by taxation, the variety of which is as great as its magnitude. The result is, of course, anarchy in the domain of public finance. There is no system of federal finance in America, the unity and co-ordination necessary for creating one being conspicuous by their absence. In the political sphere the United States of America stands for an ideal which has no future. This great republic is itself trying to circumvent its limitations by all kinds of makeshift devices, though not with unqualified success in all cases. In matters relating to finance, the United States of America serves more as a warning than an example. Its financial administration, in spite of recent improvements, is easily the worst we can find; the fiscal inter-relations of the States among themselves and between the States and the Union are characterized by a confusion and disharmony which are not known to

exist in any other federal states. But the wealth of differences that exists in the United States of America has made it a laboratory of fiscal experiments; and the study of its financial system is, on that account, of very great interest and importance.

There is, as stated above, no specific allocation of resources between the Federal Government and the States in the U.S.A. except that import and excise duties are reserved to the former under the provisions of the original constitution. In theory, the States could levy excises; but they could not do so in practice since, under the constitution, the rates of duty must be uniform throughout the U.S.A. It was also open to the Federal Government to levy an income-tax; but if it was held to be a direct tax, it had to be apportioned in the manner prescribed in the constitutional provisions relating to federal taxation. But till the end of the ninteenth century the customs revenue was the principal source of income for the Federal Government, and other taxes were regarded as supplementary to the customs. The receipts of customs taxation, however, fluctuated within very wide limits, and the country passed from a period of large and embarrassing surpluses to equally large and paralysing deficits in quick succession; and as the tariff duties were determined by political and protective considerations, their fiscal aspect received very little attention. The violent transition from surplus to deficit produced the most disturbing and demoralizing effect on federal finances. But after 1862 a system of excise duties was developed, which by the end of the nineteenth century became a very productive source of revenue. The system of excise taxes or internal revenues, as it is called, was inaugurated by Hamilton himself in order to forestall the States in the use of these duties; but it had to be abandoned in 1802 on account of its extreme unpopularity. It was again used as an emergency measure in 1812 when war broke out with England, but was once more abolished in 1817 with the return of peace and prosperity. The Civil War made it necessary to make use of every fiscal expedient to increase the revenues, and excise taxes were imposed again. By 1872 all the war taxes were repealed; but excise duties on

liquors and tobacco were continued, and became a permanent feature of the federal fiscal system. The outbreak of war with Spain in 1898 made it necessary to introduce a more comprehensive system of excise taxes, and included what we in India call stamp duties and amusement taxes. These special war taxes were repealed in 1902, but excise duties remained an important element of the federal revenue, and their receipts were sufficient to cover more than 40 per cent of the ordinary expenditure of the Federal Government from 1896 to 1910. The Great War increased immensely the fiscal necessities of the Federal Government, and it had to take recourse to a number of new excise taxes and to enhance the rate of the old ones. Some of these taxes have now been repealed or reduced ; and the development of direct federal taxes has decreased the relative importance of all indirect taxes, including both customs and excise, but the excise duties even now contribute 17·41 per cent [1] of the enormous tax revenue of the Federal Government. These duties include a wide variety of taxes, and can be called excises only in the most comprehensive sense of the word. But the development which has overshadowed the whole fiscal system of America is the imposition of federal direct taxes since 1913. Income-tax and inheritance taxes were levied during the Civil War, but were then regarded as indirect taxes. They were, however, repealed in 1872 along with other war taxes ; and the attempt made in 1894 to re-impose the income-tax, after the great commercial crisis of 1893, was frustrated by the ruling of the Supreme Court that it was unconstitutional, and the Act passed in 1894 never came into force. In 1909 was imposed the Federal Corporation Tax, which was really a tax on corporate income ; but the constitutional difficulty was avoided by calling it a 'special excise tax', and the Supreme Court upheld it on the plea that it was not a direct tax, but a tax on the privilege of conducting business in a corporate form. In 1913, by what is known as

[1] The estimated receipts of these taxes in 1926-27 amounted to 666 million dollars.—*The League of Nations Memorandum on Public Finance*, 1922-26 (to be referred to hereafter as *L.O.N.M.*).

the Sixteenth Amendment, the apportionment clause of the constitution was repealed, and thereby the Federal Government was placed in a position to use a fiscal engine of great power without which it would have been considerably handicapped in handling its war finance. It made full use of it for increasing its resources during and after the war, and now it is the most important source of revenue for the Federal Government. The estates duty was also imposed in 1916, has been developed since then, and has now a recognized place in the federal tax system. In 1926–27 the revenue of the Union from taxation amounted to 86·44 per cent of its total revenue of which income-tax contributed 40·16 per cent, the estates duty 2·88 per cent, other direct taxes 2·51 per cent, customs, once the sheet anchor of federal finance, 14·43 per cent, and excises, as stated above, 17·41 per cent.[1] War has in the U.S.A., as in so many other countries, worked a fiscal revolution, and the situation now is pregnant with great possibilities. But the important point which we have to bear in mind is that the Federal Government in the U.S.A. occupies a position of splendid isolation in the fiscal sphere; and levying as it does every kind of tax, it shapes its taxation policy, in its principles and their application, with superb indifference to the tax systems and policies of the States. That is in keeping with the spirit of the constitution of 1789, but does not answer the needs of to-day, and cannot lead to the 'scientific management' of finances, of the principles of which the U.S.A. is the leading exponent and example in the realm of industry.

The States in the U.S.A., in the fiscal as in other spheres, have all the residuary powers, and are independent of one another and of the Federal Government. The source, on which they have mainly relied, ever since they began to feel the pressure of the increasing cost of government, is the general property tax. But it has now gone to pieces on account of the escape of intangible personal property from assessment and the competitive under-valuation of real property. There has been some improvement

[1] *L.O.N.M.*

in administration on account of the appointment of State tax-commissions for the centralization of assessment; but the inadequacy of the tax, as the mainstay of the State finances, is now an established fact. The States have had, as a matter of necessity, to look for other sources of revenue, and are now making use of the corporation tax, inheritance tax, income-tax, and a number of other taxes. It is not possible to go into details, and it is sufficient to state that this search for the means of expanding revenues is not over for the States. They still find that their needs are outpacing their resources. They have imposed corporation taxes, general and special; and a number of States have introduced 'business' taxes. The movement towards the imposition of inheritance taxes received an impetus in 1891; and now all the States but two have their own inheritance taxes. Since 1911 they have also been developing their income-taxes, and now thirteen States are competing with the Federal Government in this domain of taxation, and more are likely to come into the field. They are also extending their fiscal activities in other directions, and their privilege, occupation, severance taxes are disguised taxes either on incomes or on consumption. As the exercise of their sovereign rights by the States does not leave any room for co-ordination, there is no provision for harmonization of taxation. Difficulties arising out of the conflict of jurisdiction have in a few cases been avoided by conventions; but the multiple taxation of incomes, legacies and corporations is very common, and a source of great vexation and hardship to the tax-payers. 'The possible combinations,' in the words of Prof. Seligman, 'are terrifying in their complexity,' and it is impossible to say how these complications can be removed. The Federal Government and the States have their own orbits of fiscal activities; but as these are not parts of a fiscal cosmos, the results are extremely bewildering for the tax-payers and the assessors and administrators of taxes. Dr. Albert Hensel regrets the unwholesome effects of what he calls the 'politicizing of finances in the U.S.A.', and attributes the fact of her having been able to steer

clear of serious disaster till now to her immense material resources. The mistakes of America may, in the words of Bryce quoted by Dr. Hensel, be 'the glorious privileges of youth, the privileges of committing errors without suffering from their consequences', but they cannot be repeated in any other country with impunity. The serious defects of the Meston Settlement are all due to its having been 'politicized', to its having been made merely a corollary of political re-adjustments. The experience of the U.S.A. points to the dangers of adopting such a course, and is for us a warning against the repetition of the same mistake in the new constitution.

There is another interesting development in the United States of America about which it is necessary to say a few words. Students of American affairs know that there has been, for some time, a trend towards federal centralization; and the Federal Government, besides being important in times of war, is also getting important in times of peace. This was not contemplated by the fathers of the American constitution, but as the changes in the basis of economic life have greatly increased the number and importance of matters which are national in their scope and character, and with regard to which, of course, the Federal Government was expected to be supreme, it has made it necessary for the latter to assume functions of a very diverse character. It has now its own Bureau of Corporations, Department of Commerce and Labour, Pure Food and Drug Act, Inter-State Commerce Act, Federal Reserve Banking System, Federal Trade Commission, Federal Farm Loan System, Federal Farm Bureau, and the process of the extension of its activities is not yet over. One of the methods, among others, which it has employed for widening the scope of its activities is the use of federal grants to the States for specific purposes and with a stipulation in some cases regarding the manner in which the money is to be spent. The practice is not new, and ever since the adoption of the constitution, grants of land and money have been made for internal improvement and educational purposes. But of late the grant of these subventions has imposed on the States certain obligations, the

most common among them being the State appropriation of an equal amount for the purpose for which the grant is made. This plan of ' matching dollar for dollar ' has been very widely used, and hundreds of millions of dollars have been spent on such grants since 1914. The grants have been used to promote vocational education, maternity and infancy hygiene, industrial rehabilitation, social hygiene and good roads. The construction of highways is, measured in terms of the payments made, the most important single undertaking for which grants have been given. The policy has been criticized from the standpoint of ' States rights ', but it has been upheld by the courts, and having been initiated in circumstances whose compelling effect is overwhelming, it is receiving the approval of enlightened public opinion all over the United States. There is a danger of going too far towards centralization, but in America the danger is very remote on account of the wide powers of autonomy enjoyed by the States, and the restrictions inherent in the constitution. The anarchy, which prevails in America, calls, as a matter of fact, for the application of a much more thorough policy of co-ordination, and a determined action on the part of the Federal Government to ' rationalize ' the whole system of fiscal administration. That is, however, not practical politics in the United States at present, and the Federal Government has to do the best that it can to promote objects of general utility by the use of its constitutional and implied power. In 1926–27, 110 millions of dollars were appropriated for federal grants to States; and out of this amount 80 millions of dollars were reserved for postal roads, and there was an additional obligation to find 116 millions of more for the same purpose.[1] It is also interesting to mention that the federal grants are larger in the case of rural and sparsely populated States, in view of their limited resources and more pressing needs, and are not quite as liberal in the case of the industrial and wealthy States, their distribution being regulated by the needs of the recipients and not their revenues.

[1] *L.O.N.M.*

## *Latin-American Federal Republics*

There are three Latin-American federal republics, whose financial systems have some points of interest, but their treatment has necessarily to be brief. Full information about their finances is not available; and it is necessary to economize space in order to deal with the systems of finance of the more important federal states at greater length. Some noteworthy features may, however, be mentioned. Mexico is in a state of chronic disorder; and its finances cannot, therefore, be in a sound condition. The reciprocal relations of the Federal Government and the States are not clearly defined, and there is a great deal of uncertainty regarding the delimitation of their respective spheres of competence. In financial matters the connexion between the two is close and important. Only the customs duties and port dues are reserved to the Federal Government, and as regards other taxes the Union and the States possess equal and concurrent powers. The receipts of different sources of revenue are generally shared by them, and there are otherwise numerous points of contact in the financial sphere between the two. The conditions, however, are not stable on account of the instability of the administration. In Argentine also there is, in the financial relations of the Federal and State Governments, what may be called a penumbral region; but the most outstanding characteristic of its finances is the dependence of the States on federal grants for carrying on their normal administration. Distribution of these grants is provided for in the constitution, though the subvention clause is indeterminate, and it has been left to the Federal Government to determine the amounts, the sources and the objects of these grants. The subventions are substantial, and more than two-fifths of the expenditure of some States is met out of federal grants. In Brazil there is almost complete separation of resources. The division of resources is laid down in the constitution. The States have their own independent sources of revenue, and among them the one which has to be specially mentioned is the export duties. While import duties are here, as in other

commonwealths, reserved to the Federal Government, the States have an exclusive right to levy export duties, and a number of States derive more than fifty per cent of their whole revenue from them. Other important sources of revenue for the States are duties on transfer of property, taxes on commercial and industrial establishments, vehicle taxes, etc. The Federal Government imposes direct and indirect taxes; but the former are not important, and only 6·08 per cent of its revenue was derived from them in 1926–27.[1] In the same year import duties yielded 39·87 per cent, excise duties 26·02 per cent and taxes on transactions 19·20 per cent of the total revenue. The Federal Government is, in other words, dependent upon indirect taxes to the extent of 85 per cent of its revenue. It does not give any grants to the States; but educational and other institutions, which are not a charge on the federal revenues, receive handsome grants from the Federal Government. This brief review of the federal finance of these States shows that each one of them has followed its own line of development; and their financial settlements have not been framed after the same pattern. It would have been surprising if it had been otherwise; for each State has its own needs, and what is more the Latin temperament is averse to standardization.

### *Switzerland*

In Europe there are four Federal States:—Switzerland, Germany, Austria and Russia. Of these Switzerland is the smallest, both in point of area and population (its population is little more than half of that of Assam, the smallest Province of India, and its area is even less than that of Berar); but still a study of its financial system is of very great interest, because it is, in a sense, the oldest federation, and has developed on lines which have made its institutions an object of special interest to the students of constitutional history and political science, and 'the Swiss Federation', to quote Dicey's words, 'is the natural outgrowth of Swiss history and bears a peculiar character of its own that will repay careful

[1] *L. O. N. M.*

study.'[1] The same statement can be made with regard to the Swiss financial system. It is intimately connected with the political institutions of the Swiss Republic, and is animated by the same spirit. The Swiss constitution is, as is well known, as flexible as the American is rigid; and its developments have kept pace with the growing needs of the political life of the people. The residuary powers are vested in the Cantons, and they are not by any means merely administrative districts; but the Federal Government is not an outside authority in respect of the functions assigned to them, and is actively associated with the whole cultural and social life of the people. It has assumed a number of important progressive functions; and in spite of the fact that the execution of policies is in most cases entrusted to officials under the direct administrative control of the Cantons, it is in living contact with their political life. There is a clear demarcation of the fiscal spheres of the Federation and the Cantons, and they do not encroach upon each other's jurisdiction, but there is nothing like segregation of resources. There is a number of divided heads of revenue, and the Cantons receive grants for specific purposes from the Federal Governments. The financial settlement between the Federation and the Cantons has, since 1874, the year in which the present constitution was adopted, been constantly modified. Re-adjustments have been easy and made without any delay; and there is, therefore, no maladjustment between the needs of the Swiss Republic and its system of federal finance. Switzerland is, to use a word which is expressive though not altogether suitable, an integrated federation. Its constitution has not been framed with a view to establish a balance of powers; and it is possible for it to meet new contingencies with an assurance which is lacking in the United States and some other federations on account of a different conception of federalism. Switzerland is a very small country; but is, as Dicey has said, by nature a federation, and has realized multiple unity in her national life.

[1] Dicey, *Law of the Constitution*, p. 517.

The functions which are exclusively assigned to the Federal Government are few. They are defence, posts and telegraphs, control of insurance companies and emigration. But the Federal Government lays down fundamental conditions for the discharge of functions which have to be performed by the Cantons, and provides funds for the purpose. The matters of which it thus takes direct cognizance are many and important, and the Cantons with regard to them are in the position of self-governing but not autonomous units. The part played by the Federal Government has to be specially mentioned. It has been given power in the constitution to establish its own educational institutions; but it has, excepting the Federal Polytechnic Institute in Zurich, not got any institutions of its own. The Universities and the Secondary Schools are looked after by the Cantons; but with regard to primary education, the Federal Government has assumed power of exclusive control, provides funds, and has, by legislative measures, determined the essential conditions for the administration and development of the system. For the discharge of these and other functions, the Federal Government imposes direct and indirect taxes; but the former have an unimportant place in its revenue system. Before the war, the only direct tax in which it was interested was the military (exemption) tax, which was and is levied by the Cantons, but half of whose gross receipts go to the federal exchequer. In 1915 an income-tax was introduced to meet the cost of mobilization, but was and is treated as a special war-tax and, according to the present programme, will be abolished in 1934. Income-tax yields about five per cent of the total revenue, and is being used for the amortization of debt. The bulk of the federal revenues is derived from indirect taxes. In 1925 the proportion contributed by them was 72·80 per cent, of which the share of customs was 61·22 per cent.[1] Before the war the customs were responsible for 81·6 per cent of the total federal revenue. Of the other indirect taxes, the most important is stamps, the

[1] *L.O.N.M.*

yield of which in 1925 was 9·94 per cent. The Federal Government has some monopolies and public undertakings, but they are not very productive from the fiscal standpoint. It shares with the Cantons the receipts from these sources and also, to a certain extent, the yield of war taxes and stamps. This shows that the Federal Government relies mainly upon customs for its revenues, which is due (besides, of course, the undeveloped state of direct taxation) to the fact that excise duties are unknown in Switzerland. It has been estimated that, if a system of taxation of liquor similar to the English, were introduced, it would yield about 310 million francs. But a proposal to levy an excise duty on liquor was rejected by a referendum in 1923. The Swiss people have obviously a strong prejudice against these duties; and the introduction of what Jefferson called this 'infernal system', is not likely in Switzerland. The result, of course, is that the Federal Government has to depend upon customs, the yield of which is liable to great fluctuations, and likely to shrink in times of war. But the inviolability of Swiss territory has been guaranteed by the Great Powers since 1815, and the danger of Swiss neutrality being violated is so remote that the narrow basis of the federal fiscal system need not be considered an element of weakness from that standpoint. It may be desirable to develop direct taxes further, but there is no necessity for it just at present, and as in financial matters opportunism has been the guiding principle of the Swiss Federation from the very outset, it is probable that the income-tax law will be allowed to expire in 1934. The Federation is also entitled to levy contributions on the Cantons in times of emergency, but it has not made use of this power since 1849; and that may now be regarded as having been relegated, in the words of an eminent Swiss financial expert quoted by Hensel, 'to the historical lumber-room'.

The Cantons exercise the fiscal powers which have not been expressly allotted to the Federal Government. The most important source of revenue for the Cantons is the tax on land, property and professions, which in

1924 yielded 174 million francs.[1] The other direct taxes contributed 23 million francs, indirect taxes 39·4 millions, and the taxes administered by the Federal Government 25·2 millions. The total revenue of the Cantons in that year was 510 million francs, and the balance over their tax revenue was made up by their receipts from cantonal property and from federal grants, ordinary and extraordinary. The variety of taxes imposed by the Cantons is very great, and gives them a very wide fiscal sphere of their own.

The most distinctive characteristic of federal finance in Switzerland is the system of assignments and subventions to the Cantons, which has made it possible for the country to adjust itself to the changing circumstances. The assignments are a share of the receipts of the Federal Governments, which have been granted in most cases to compensate the Cantons for the loss of revenue on account of some new developments. The tax on commercial travellers is, for example, collected by the Federation, but its yield is handed over to the Cantons. The primary object of the levy is to regulate the trade and commerce of the country; and since it can best be fulfilled by making it a federal subject, it is administered by the Federal Government, but the latter does not add to its resources thereby. Similarly the revenue from the liquor monopoly and the bank note issue is also shared with the Cantons, as these functions have been assumed by the Federal Government for non-fiscal reasons. The liquor monopoly was introduced to check its consumption, and as it entailed some financial loss to the Cantons they have been allowed to take a part of its income.[2] In 1905, on account of the establishment of the National Bank and the centralization of the note issue, the Cantons had to give up their right to levy their bank-note tax and to issue notes

[1] *L.O.N.M.*

[2] One-tenth of this income has to be expended for combating alcoholism in its causes and effects. To this extent, the amount received by the Cantons from the Union is not really an assignment but a subsidy in the sense in which this term has been defined later in this chapter.

of their own. This again meant loss of revenue, and the Cantons had to be compensated. The Cantons derived 11 million francs in 1911 from assignments; and this amount had, as stated above, risen to 26·2 millions in 1924. These are adjusting assignments, or what the Taxation Enquiry Committee would call balancing factors. The administrative necessity of centralizing a function has been met by letting the Federal Government assume the function, and compensating the Cantons for the loss of their revenue. The revenue derived by the Cantons from this source is theirs by right, and does not weaken their autonomy. The subventions, however, are on a different footing, and are granted by the Federation for specific purposes, and subject to certain conditions. They are granted for objects of social utility, and the Federal Government exercises powers of approval and supervision with regard to the purpose and manner of their expenditure. The risk of the Federation increasing its power unduly at the expense of that of the Cantons is, of course, there; but it is well known that the Cantons are an important factor in the political life of Switzerland, and are not dominated by the Federal Government. The subventions have had a great educative value for the Cantons, and spurred them to activities of vital importance from the national standpoint. In 1903 the subventions amounted to 24·2 million francs, and in 1927 to 57·5 million francs.[1] The fact that the execution of the policies in question is in most cases left to the Cantons makes it necessary for the Federal Government to utilize the subventions as a means of financial settlement in each individual case. These adjustments are frequent and many; and as the traditions of cantonal autonomy are strong and well-established, it is possible for the Federal Government to stimulate the progressive development of the country by a free use of the subventions without undermining the federal character of the whole constitution. The fact that the Swiss Federation is an indigenous growth is a great safeguard against any unwholesome development of this kind.

[1] *L.O.N.M.*

*Germany*

A careful study of the system of federal finance in Germany is necessary for a number of reasons. The German Constitution is a child of revolution. It embodies the aspiration of a valiant nation to assert the integrity of its national life against the disruptive effects of a crushing defeat and the working of the reactionary forces which had been so powerful under the Constitution which it has replaced. It is also an experiment in the application of new political principles of great potential importance. It has been said that the constitution of 1919 'vibrates with tramp of the proletariat'. That is so inasmuch as it bears the impress of a conspicuous attempt to broaden the base of national culture, and establish it on the foundations of a highly organized and developed social life. The avowed object of the constitution is 'to promote the highest cultural and economic efficiency of the people',[1] and the provisions for territorial re-distribution and the administration of economic life have been framed with that end in view. They have led to the creation of institutions, which are, in some cases, regarded as costly failures; but the German constitution is to be judged not by its achievements, though these in themselves are a record to be proud of, but by its promise. Opinions are divided regarding the essential character of the new constitution. The Reich has become supreme in all matters under the law, and the States, or rather the Länder (territories) as they are called, have no inherent rights which limit the exercise of the authority of the Reich. This is, however, merely a legal aspect of the matter; and as Professor Herman Kautorowic has said, 'The right of the Reich to treat its territories as Provinces is unquestionable, but it could not dream of using such a right.'[2] The German constitution is in fact federal; and the prevailing opinion in favour of this view is strong, and based on intuitive appreciation of the realities of the situation, in spite of

[1] Article 18 of the Constitution.
[2] *Economica* March 1927, p. 46.

many reasons urged against its validity, which, of course, are derived from a dogmatic interpretation of the provisions of the German Constitution. In consonance with the spirit of the whole constitution, the Reich has acquired also very wide financial powers. It administers and controls the most important taxes of the Republic, and exercises powers of supervision and regulation over the States in all financial matters. It has the right to utilize all taxes and other sources of income, in whole or in part, for its own purposes, subject to the condition that it has to make adequate provision for carrying on the administration of States, if it claims any source of revenue which formerly belonged to them. Its hegemony in financial matters is complete, and with regard to them its structure can hardly be distinguished from that of a decentralized unitary state. But that merely shows that Germany has, by a conscious effort, sought to establish conditions which are held to be essential for efficiency and for the harmony of financial institutions in all Federal States. The financial system of Germany is still in the making, and is, therefore, in a highly plastic state. It has had to function in adverse circumstances since its very inception, and as the international liabilities of Germany are still very heavy, it will take some time before a state of normal equilibrium is established. It may even be necessary to take measures to counteract its centralizing tendencies, after a further experience of its actual working ; but there is no doubt that the system of federal finance in Germany is, in several important respects, in advance of the systems of other Federal States, and may later on become a model for their development.

About the financial settlement of the German Empire it is unnecessary to say much. The Empire had the sole right of legislation in all affairs relating to customs, and in the taxation of salt, tobacco, beer, spirits and sugar. It was also empowered to levy direct taxes, though it did not make use of this power till 1906, when a federal inheritance tax was levied and its yield was shared between the Empire and the States in the proportion of two to one, which was changed to three to one a few years later on account of the heavy burden of the naval

programme of the Empire. The fiscal necessities of the Empire also caused an extension of the number and scope of excise duties, and they were utilized to make encroachments on the fiscal sphere of the States in a disguised form. Customs and all other taxes were assessed and collected by the officials of the States, but their revenue went into Imperial treasury subject to the deduction of the cost of collection. The distinctive feature of the financial system of the German Empire was the payment of contributions by the States. They were introduced in 1871 as a provisional measure to make up the Imperial deficit, and would have been remitted in 1879 but for the fact that they came to be regarded as the constitutional guarantee of the right of the Empire to levy them to meet its own needs, and were continued, in spite of the fact that they were in most years covered by Imperial assignments to the States. But their amounts and those of the covering assignments were uncertain, and their effect on the finances of the States was very disturbing. The States imposed taxes which were not exclusively assigned to the Imperial Government. Their tax-systems included income-tax, inheritance tax, excise duties, and taxes on property. They also derived revenue from railways and other public undertakings. Posts and Telegraphs were an Imperial concern. The Empire gave grants for specific purposes, and these became an important factor in its finances just before the war. The financial relations of the Empire and the States were not marked by any degree of cordial co-operation; and every proposal for change or adjustment gave rise to bitter disputes.

The financial settlement of the new German Republic has been separately provided for by the Law of Taxation of the States and the National Duties Ordinance, and can be changed without the necessity of resorting to the process of constitutional amendment. Under the Law of Taxation of the States, there is a definite delimitation of fiscal jurisdiction. The States can impose only those taxes which do not in any way affect the financial supremacy of the Republic or go contrary to the 'presumptions' of its constitution. That, in effect, means that the Reich has a prior claim in all cases, and doubtful and disputed points

have to be submitted for the decision of the Federal Finance Court (Reichsfinanzhof) or the Reichsrat, the Upper House of the Republic. The Reich derives its revenue from customs, and excise duties, direct taxes, and taxes on transport and transactions. In 1927–28 indirect taxes were estimated to yield 16·54 per cent of the total revenue, direct taxes 35·57 per cent, taxes on transport 4·84 per cent, and taxes on transactions, the most important of which is the turnover tax, 13·13 per cent.[1] The States share in the yield of income-tax, corporation tax, turnover tax and the tax on real estate transactions. The proportion of these taxes assigned to them are not fixed, and are changed every year to suit the exigencies of the situation; but the yield of these divided taxes is important for the finances of the States, and they are guaranteed a certain minimum, in order that they may be able to frame their budget estimates on an assured basis. The amount thus guaranteed was 2,100 million marks for 1924–25 and 1925–26. In 1926–27 Prussia, which embraces three-fifths of the whole area and the whole population, was estimated to receive 668 million marks from the taxes of the Reich, and to raise 1167·5 million marks from its own taxes. The tax-revenue of Bavaria was estimated at 500·4 million marks for 1925 and 461·6 millions for 1926, of which 324·4 and 285 millions, respectively, were transfers from the Reich.[2] Taxes which the States levy on their own account are taxes on lands, buildings and trades, and taxes on vehicles and on entertainments.

The law also recognizes the necessity of grants by the Reich to the States for specific purposes. For all undertakings in the cultural, economic and social spheres, whose importance extends beyond the limits of the States, they are entitled to receive subventions from the Reich, which, of course, determines their amounts and the conditions under which they are granted. The grants have already attained very large dimensions; and in 1926–27 Prussia was to receive, besides the revenue assignments referred to above, a sum of 328·8 million marks as grants for

[1] *L.O.N.M.*  [2] Ibid.

specific appropriations. In 1926–27 and 1927–28 210 million and 190 million marks, respectively, were given to the States by the Reich in aid of the police expenditure. These subventions are an important feature of the new financial settlements. The railways have now been taken over by the Reich, and are administered as 'a single undertaking'. They and Posts and Telegraphs have been constituted into autonomous corporations, and have their own assets and their own liabilities.

The Reich now administers its own taxes by its own officers, and has established a complete set of courts for the disposal of revenue cases. The Finance Court is the supreme authority in all matters relating to the administration of federal taxes, and secures unity of jurisdiction for them. The States have their own officers for the administration of their taxes; but provision has been made under the National Duties Ordinance to co-ordinate their activities with those of the federal officers, and bring them into line with the latter. The movement towards the Reich's officers administering some of the States' taxes has already commenced; and it is likely that, except in cases where a tax is of a purely local character, the Reich will assume the responsibility for administering all taxes. It is clear that it is proposed to prevent all unnecessary duplication of the administrative machinery of taxation.

The responsibility of the Reich in the fiscal sphere does not end with the provision for administrative co-ordination.[1] The Constitution definitely requires it to prescribe by law fundamental principles concerning the validity and mode of collection of State taxes in order to prevent:—

(1) injury to the revenues or to the trade relations of the Commonwealth;

(2) double taxation;

(3) the imposition of excessive burdens or burdens, in restraint of trade, on the use of the means and agencies of public communications;

[1] Article 11 of the Constitution.

(4) discriminations against the products of other States in favour of domestic products, in inter-State and local commerce; or

(5) export bounties;

or in order to protect important social interests.

These are very wide powers, but none too wide for the efficient discharge of duties which must devolve on the Commonwealth in every Federal State. The conflict of jurisdictions is a growing evil in the fiscal administration of all countries, and it is necessary to take effective measures against its far-reaching reactions on the whole economic life. The framers of the German constitution have realized this fact, and made the Reich the custodian of fiscal harmony within the Republic. These and similar provisions are not an evidence of their desire to make the Reich all-powerful, but of their understanding of the basic facts of economic life, and their determination not to let the fiscal system of the country develop in a manner prejudicial to its economic and social unity. They have, as already remarked, made an attempt to keep abreast of the times, and develop their institutions in accordance with the world-wide trend of events. In details it may be necessary later on to modify or revise their arrangements, but their principles are likely to stand the test of experience. They have been wise enough to understand the tentative character of their whole plan of financial adjustment, and by taking it out of the constitution they have greatly facilitated the task of introducing changes which may be suggested by the later developments of theory and practice.

## *Austria*

Austria has also been declared to be a Federal Republic and consists of nine provinces (Länder), one of which is the city of Vienna, whose population is 28 per cent of the whole population of the country. According to the scheme embodied in the Protocol of 1922, Austria has been enabled by the League of Nations to rehabilitate her finances, and her financial position is now sound and stable. The Federal Government retains the supreme

fiscal power, and has the right to decide what taxes shall be reserved for the Federation, and also those whose yield is to be shared between it and the Provinces. The taxes are either exclusively federal or exclusively provincial, and the rest are to use the familiar term 'divided heads'. The taxes, whose yield is shared between the two authorities, are either administered by the Federation, the Provinces being allowed to take a fraction of their receipts according to a concerted scale, or they are administered by the Federation, and the Provinces are permitted to impose surcharges of their own, or they are such that the Provinces can levy an analogous tax on their own account. The Federation administers, besides customs and excise, an income-tax, a corporation tax, succession duties, a turnover tax, stamp duties and fiscal monopolies. It has also a number of public undertakings, which have been, however, transferred to autonomous economic organizations. The Provinces levy taxes on lands, buildings, domestic servants, increment of value, vehicles, entertainments, luxuries, and a surcharge on transfer of property, betting and successions. Excepting the import duties, the yield of most of the important federal taxes is shared with the Provinces in different proportions, and an assignment of a minimum amount is generally guaranteed to them. They also receive subventions from the Federal Government for specific purposes.[1] In 1924 the taxes of the Provinces yielded 58·96 million shillings, their share in joint taxes was 42·70 millions, and they received from federal grants 12·36 millions. It is clear that a very large proportion of their revenues comes from the federal exchequer.

Austria has risen, Phoenix-like, from her own ashes, but she has been doing fairly well since her resurrection. As a minor power, she may even be better off than she was when, as the centre of an heterogeneous Empire, she could claim a seat among the Great Powers. Her comparatively obscure position ensures for her a greater degree of security, and she can proceed with the work of reconstruction without feeling the necessity of

[1] *L.O.N.M.*

spending huge amounts on armaments. Her expenditure on defence in 1926 was estimated to be only 5·65 per cent [1] of her total expenditure, and she was spending very large amounts on education and schemes of social welfare. Though a federation in her constitutional structure, Austria is more like a unitary State; but her finances bear a close resemblance to the settlements of some federal states, and the fact that each Province has its own legislature and executive council with a sphere of competence, within which it enjoys a very large measure of autonomy, will in due course make Austria federal in reality in the sense in which Germany, Canada and South Africa are and will remain federations. It may be that she will eventually throw in her lot with Germany, join the German Reich, and become one of its States. Article 80 of the Peace Treaty makes that impossible in the present circumstances; but as the Peace Treaty has to be scrapped if world peace is to be something more than an idle dream, the union of Austria with Germany is one of the possible developments of the future. This, however, is a digression. What interests us just now is that Austria's financial system is based on the recognized necessity of promoting local initiative and enterprise without impairing the efficiency of the organs of national life. Austria's constitution is an experiment in the new federalism, and its finances are designed to express and realize its social purpose.

### *Russia*

About Russia very little is known that is authentic, and the available information regarding her finances is even more scanty and unreliable. But she is a federation; and two of its constituent Republics are themselves federations. Deliberate attempts, made during the first years of the Revolution, to destroy the monetary system also involved the destruction of the fiscal system, and the restoration of the currency on a gold basis has also necessitated the return to a budget economy. Since 1923–24 a great deal of progress has been made in the stabilization

[1] *L.O.N.M.*

and development of the fiscal resources of the Union. The federated Republics, according to all accounts, have been given independence within the spheres assigned to them, and are doing good work in organizing their own life. In matters relating to culture and social economy they are developing on lines suited to their local circumstances; and though, on all vulnerable points, the will of the communist executive is supreme, a conscious effort is being made to give free play to vital forces. The whole political system of Russia is in the early stages of its development, and all the tendencies inherent in it have not been fully worked out as yet; but its federal structure and the conception of the Soviet organization carry with them a presumption that the whole society is to be organized on a federal basis. The fiscal system of the Union, which may fit in with its political constitution, has still to be evolved. It is being elaborated; but 'the actual financial powers at present held by the various components of the Union are,' to quote from the *Report of the British Trade Union Delegation*, 'so varied in precept, vary so much in practice from the precept, and are still so clearly in rapid development that it is impossible to review them here.' [1] The Union makes use of all the usual taxes, and derives considerable revenue from non-tax sources. From the statistical abstract, published by the Central Statistical Board of the U. S. S. R., it appears that in 1926–27 the tax-revenue amounted to about forty per cent [2] of the total revenue of the

[1] *Report of the British Trade Union Delegation, 1925*, p. 76.

[2] The total estimated tax-revenue in 1926–27 was 23,336 million roubles and the total revenue 50,024 million roubles. Of this amount the revenue appropriated by the Union itself was 37,441 millions, and the rest was assigned to the Republics. These, though all considered autonomous financial entities, are of varying sizes, and their assignments range from 186 million roubles in the case of the Turcoman S. S. R. to 8,614 millions in that of the R. S. F. S. R., which is Russia proper. This Republic is, as stated in the text, itself a federation. Its population is more than 100 millions out of a total population of 147 millions, and its area is 7,626,717 out of a total area of 8,241,921 sq. miles. It is not surprising that in the counsels of the Union Russia carries very great influence.

Union, and the rest was derived from State property and undertakings; and from 1922–23 to 1926–27 the yield of tax and non-tax sources of revenue considerably increased. The constituent Republics derived their revenue from the same sources, though they had their own property and undertakings which contributed considerable revenue to their treasuries. Most of the sources of revenue were joint, and were administered and controlled by the Union. The Republics, according to the *Report of the British Trade Delegation*, cannot impose fresh taxation without the sanction of the Union. This centralized control will have to be relaxed; but the whole scheme of organization is exceedingly interesting and instructive, and its financial counterpart will in due course develop into a system which will have special features of its own. The Soviet political philosophy is essentially pluralistic, and a system of centralized finance cannot possibly do for it in its pragmatic aspects. In Russia there are already a number of autonomous financial entities; and as they 'draw air into their lungs', they will become vital factors in the structure and operation of her finances. No one can say what Russia will be ten years hence, but it has great possibilities in the sphere of public finance as it has in all other spheres.

### *Canada*

There are three federations in the British Empire, whose financial systems may be described before bringing this chapter to a close. Of these, Canada is the oldest; and the development of the Dominion Government there is a triumph of British statecraft, and is of great interest for the student of federal finance. In spite of the fact that residuary powers are vested in the Dominion Government, Canada is, to quote the words of the British North America Act, 1867, 'federally united into one Dominion', and its financial settlement has been conditioned by this fundamental feature of its constitution. But the actual working of its financial system has to a very large extent been determined by certain other factors, among which the most important is the administration of finance on

lines dictated by party interests. The 'spoils system' and waste of public money for promoting purely party ends have lowered the standard of public morality and led to the sacrifice of all sound principles of public finance, and financial administration. The relations between the Federal Government and the Provincial Governments must necessarily leave a great deal to be desired when the party returned to power makes use of federal funds to reward the constituencies which have polled in its favour and to penalize those that have been less amenable to the control of the party managers. The Provincial Governments have also imbibed the same tradition and are in the habit of using for purely local needs funds derived from the federal treasury. The organization which exists for financial administration in Canada is not different from the British, but in respect of efficiency and integrity they represent the two extremes; which only shows how little depends upon the system, and how much upon the spirit in which it is worked. The evils which have arisen on account of these corrupting influences have created an atmosphere which is not conducive to the health or vigour of the financial system. It is only an incidental condition of the operation of the financial settlement; but it is there, and affects its actual working.

In 1867, under the Act of the Union, the Dominion Government acquired wide fiscal powers. It was granted the exclusive right to levy and collect customs and excise duties, and Parliament was authorized to legislate upon 'the raising of money by any mode or system of taxation'; but in actual practice customs and excise duties were the main sources of revenue for the Dominion Government. In 1914, they accounted for receipts amounting to 126 millions of dollars out of total receipts on 'consolidated funds' account of $163 millions; and of the remainder the Post Office and Government railways furnished between them more than $26 millions which was, however, offset by expenditure on those services, amounting to over $27·5 millions. Miscellaneous revenue in that year was largely made up of fees, and amounted to $10·7 millions. The war made it necessary to impose other taxes, and

their yield has since then considerably increased, being in 1926 $157 millions, while customs and excise duties contributed $127 millions.[1] The war taxes comprise taxes on banks, insurance companies and other corporations, a business profits tax, income-tax, sales tax and stamp duties. Of these the most important, from the point of view of yield, are the income-tax and sales tax. These taxes are now a permanent feature of the federal fiscal system, and the fact that they are still called war taxes is indicative more of their origin than their purpose.

Under the Act of 1867, the Provinces were allowed to impose direct taxation 'within the Province . . . for provincial purposes' and licence fees; but in earlier years they did not feel the necessity of making use of their powers as the revenue derived from subsidies, natural resources and fees for specific services rendered was sufficient for meeting the provincial expenditure, which was not large on account of the limited scope of their functions. But from the commencement of the twentieth century the Provincial Governments have had to incur growing expenditure on education, sanitation and the operation of public utilities, and have had to levy taxes to supplement their resources from other sources. In 1925 the total receipts of the Provinces amounted to $132 millions, out of which the tax-revenue was $65 millions. This latter sum was made up of $11 millions, the yield of succession duties, $26 millions, the yield of corporation taxes, and $28 millions, the yield of licence fees. In the administration of succession duties difficulties have arisen on account of the conflict of jurisdiction. They have been partially overcome by making reciprocal concessions, but the solution of the problem of double taxation in Canada has still to be found. It will need a large measure of central co-ordination. The tax revenue of the Provinces is still inadequate for their needs, and can be further developed.

The feature of the financial settlement, which has attracted the greatest attention, is the payment of what are called provincial subsidies, but are really provincial

[1] *The Canadian Official Year Book*, 1926.

assignments. These assignments in 1925 amounted to $12,375,128, or about one-tenth of the total receipts of the Provinces. They were introduced in 1867 as a balancing factor. As the Provinces were deprived of their revenue from customs and excise duties, they were compensated by the grant of these assignments, which were of two kinds, a specific sum to meet the expenses of the Government, and a grant of 80 cents per head of population. Special indemnities, recurring and non-recurring, were given to the Provinces which joined the federation later, to make up for want of public lands, the rights over which were vested in the Crown, and also for the cession of other privileges. In 1902, 1903 and 1910 inter-provincial conferences were held with the purpose of petitioning for the increase of the annual assignments, and as a result thereof the Act of 1867 was amended in 1907 to enable the Dominion Government to revise the whole arrangement. The grants, under the amended Act, are still specific and general; but both vary according to the population. The minimum sum fixed for the expenses of the Government is $ 100,000 for all Provinces, having a population under 150,000, and is to be increased up to $ 240,000 according to the growth of population. The *per capita* grant is 80 cents until the population reaches 2,500,000, when the rate is reduced to 60 cents per head on the number in excess of this limit, on the assumption that the conduct of public administration is subject both to the laws of decreasing costs and increasing returns. Special grants were given to British Columbia and Prince Edward Island. As a result of these changes, the total amount of these assignments was increased from $4,516,038 in 1906 to $9,032,775 in 1909, and has since then risen to $12,375,128 in 1925. This amount has not grown in the same proportion as the federal revenues or the provincial revenues, for the former have increased from $85 millions to $380 millions during this period, and the latter have increased four-fold since 1916, having risen from $16 millions in that year to over $65 in 1925. But it is their quality, and not their quantity, which has given these assignments a special place in the financial system of

Canada. The Hon'ble George E. Foster, the late Finance Member of the Dominion, thus described the effects of the arrangements as they existed before 1907: 'The Provinces have mostly fixed revenues, pretty well-defined, and not very elastic. For increase beyond these, they can resort to forms of direct taxation, a proceeding which is unpopular and might be dangerous to party managers. The tendency, therefore, is to constantly press upon the Federal Government for adjustment and additional allowances. . . . To spend money extravagantly in the Provinces, and for largely party reasons, with the distant hope that eventually the Dominion Government can be persuaded and forced to come to the rescue, is not an unknown contingency in the history of our party politics, and the contingency constitutes an element of menace to the stability of the confederation itself.' [1] It was to avert this danger that the terms of the assignments granted under the Act of 1907 were declared 'final and unalterable', though the right of making special grants to particular Provinces in the light of subsequent events or changes was reserved to the Dominion Government. The situation has now appreciably improved, and the Provinces have developed their resources, but even now federal contributions constitute a very large proportion of the total revenue of Provinces like Prince Edward Island and British Columbia; and in the opinion of some competent students of the subject, the abandonment of the assignments is absolutely necessary for purging the country of a number of financial abuses. But they are only one aspect of the pernicious practice of using public funds to further party interests; and it is generally recognized that the practical and constitutional difficulties in the way of abolition of the provincial assignments are almost insuperable. Their relative importance in Dominion finances has, since their introduction in 1867, decreased. In that year the Dominion Government paid twenty-four per cent of its revenues from customs and excise duties to the four Provinces then in the

[1] Quoted from an extract given by Dr. S. Vineberg, ***Provincial and Local Taxation in Canada***, p. 163.

Union, and now out of total federal revenues of over $380 millions, the assignments to nine Provinces, as already stated, amount to $ 12,375,128, i.e. less than three per cent of the total Dominion receipts. They neither involve any heavy strain on the resources of the Federal Government, nor can they be described as 'an element of menace' to the Dominion; but the history and effects of these assignments illustrate the risks of granting the power of spending money which does not carry with it the obligation of providing it. They also point to the necessity of making such grants in some way proportional to the extent to which the constituent units of a federation are prepared to help themselves in the management of their finances. The Dominion Government has, besides granting these assignments, provided funds for local improvements at the expense of the federal revenues, and that again at the biddings of the party managers. The evil has taken root, and is now deep-seated; but it is a symptom of a disease the prevalence of which in modern democracies damps the enthusiasm of even their most ardent admirers. At the same time, it cannot seriously be maintained that the criticism directed against the system of assignments in Canada is based merely on ignorance or prejudice.

The Dominion Government also gives grants for specific purposes. Under the Canadian Highways Act, 1919, it has spent $20 millions for the purpose of constructing and improving the highways of Canada. It has also given grants to the Provinces for agricultural and technical education on a population basis. The Provinces have to spend as much for technical education out of their own revenues as they get from the Dominion Government. These grants are unobjectionable and have given a great impetus to the development of the services for which they are allotted.

### *Australia*

The Australian States are united into 'an indissoluble Federal Commonwealth', whose constitution is in many respects similar to that of the United States of America. The Commonwealth has unlimited constitutional powers

of taxation, and in respect of customs and excise duties it has an exclusive jurisdiction. The States possess concurrent powers over all taxes except customs and excise. Till the outbreak of the War, the Commonwealth derived its revenues mainly from indirect taxes, and the States had the field of direct taxation to themselves. But the increasing cost of federal administration made it necessary for the Commonwealth to enter what had been practically a close preserve of the States, and to develop direct taxation to a very considerable extent. The result was that what the Australian Commission on Taxation called 'the sovereign right of the Australian tax-payers to have the mechanism of taxation so designed and controlled as to impose the minimum of inconvenience and involve the minimum of cost', was attacked from all sides. The States enhanced their rates of taxes, the Commonwealth rates were also high, and the tax-payer not only had to shoulder a very heavy burden of taxation, but the maxims of simplicity, convenience and economy were sacrificed at every step in the fiscal administration of the country; and it was felt necessary to devise means by which these difficulties could be surmounted. Inter-state conferences of taxation officers and of premiers were convened and the question was discussed. A Royal Commission was appointed to recommend measures for the harmonization of Commonwealth and States taxation and the simplification of the duties of tax-payers in respect of the returns required of them. Proposals and counter-proposals were made by the Commonwealth and the States for finding a remedy for the trouble. The right to self-determination and autonomy on the part of the States had to be kept inviolate and other constitutional rights safeguarded. It was, in these circumstances, not easy to evolve a solution, but some progress has been made in the direction of administrative co-ordination. Australian federation is animated by the American spirit of delimitation of spheres and definition of rights; and the Australian people have much to learn in the school of experience and much hard thinking to do in order to acquire the outlook necessary for solving the problems of federal finance. But they have started

to move in the right direction, and may be expected to go ahead.

The Commonwealth constitution, as already stated, confers almost unrestricted powers of taxation upon the Commonwealth Parliament, subject to the qualification that there shall be no discrimination between States or parts of a State. The Commonwealth has exclusive power to impose customs and excise duties. These duties were to be uniform, and for ten years 'after the establishment of the Commonwealth and thereafter, until the Parliament otherwise provides', the Commonwealth had to return to the States three-fourths of the net revenue from customs and excise, one-fourth only being available for Commonwealth expenditure. The share of each State in the customs' receipts had to be calculated according to the goods consumed in that State. This necessitated an elaborate system of book-keeping, and was very vexatious for the commercial community. In 1910 this system was abandoned, and replaced by a payment of 25 shillings *per capita* according to the population of the States. In the same year, the Commonwealth imposed its first direct tax in the form of a progressive land-tax on the unimproved value of land. In 1915, on account of the enormous increase in the Commonwealth expenditure arising out of the War, it was decided to impose an income-tax; an estate duty, a war profit tax and an entertainments tax were introduced soon after, and in 1924–25 out of the total tax revenue of £52·8 millions, the yield of the direct taxes amounted to £15·6 millions, the rest being made up of customs and excise receipts.[1]

The revenues of the States are derived from taxation and public undertakings, the most important of which are Railways and Tramways. The net revenue from State property and undertakings in 1924–25 was £19·5 millions; and the tax revenue in that year was about £20 millions.[2] The revenue from State undertakings is, therefore, as important as the tax revenue. For the latter the States impose an income-tax, probate duties, a land

[1] *Official Year Book of the Commonwealth of Australia*, 1926.
[2] *L.O.N.M.*

tax and company tax, and an amusements tax. Some of them also have introduced taxes like an ability tax and a dividend tax, which are really disguised income-taxes. The rates of succession duty and income-tax differ widely in different States. Several attempts have been made since 1916, by Commonwealth and State authorities, to secure uniformity of taxation legislation, the creation of a single collecting authority and the adoption of one form of income-tax return. Three conferences of the premiers, two of the taxation officers, one of the treasurers and a board of enquiry held meetings to consider the questions of having one collecting authority for the Commonwealth and the States and one form of return; but, except for an agreement entered into between the Commonwealth and the State of Western Australia in 1920, under which the former undertook to collect the taxes for the latter, nothing was done till 1921, when the Royal Commission on Taxation was appointed to report upon this and other questions of taxation. The Commission was of opinion that only by a delimitation of spheres, or allocation of subjects of taxation, between the Commonwealth and the States could an ordered and satisfactory system of taxation be brought into being in Australia.[1] They recommended that power to impose an income-tax should be exclusively vested in the Commonwealth, and power to impose other forms of direct taxation—land, probate, entertainments—in the States, but as they regarded it as impracticable that the Commonwealth and the States should surrender immediately and permanently their existing powers, they proposed the adoption of a provincial scheme, under which the States were to have exclusive operation in the field of all direct taxation except income-tax, with regard to which the Commonwealth and the States were to retain their concurrent powers. There was to be a uniform system of assessment of income-tax, which tax was to be administered by the Commonwealth, and its cost of collection distributed between it and the States upon an agreed

[1] *Second Report of the Australian Royal Commission on Taxation*, p. 78.

basis; and the Commonwealth was to grant financial assistance to any State or States in order to facilitate the financial adjustments necessary under the scheme. The provisional scheme was to be tried for ten years, after which the allocation of subjects of taxation was to be inaugurated by mutual agreement. During the transition period, and thereafter, the right of the Commonwealth to have exclusive jurisdiction over customs and excise was to remain intact. A conference of premiers met in May 1923, and considered a plan by which the entire taxation system of Australia could be simplified and the capitation grant of 1910 terminated. In 1924 a system was inaugurated, under which the Commonwealth Central Taxation Office assessed Commonwealth income-tax on all tax-payers whose income was derived from two or more States, while in all States except Western Australia taxation officers of the States collected both classes of income-tax. In Western Australia there has been, since 1920, one collecting authority only, i.e. the Commonwealth. In 1926–27 a new arrangement for the division of the proceeds of direct taxation between the Commonwealth and the States came into force. The direct taxes were collected by the Commonwealth, and their yield was either to be handed over to the States, as in the case of the estate duty and entertainments tax, or divided between them and the Commonwealth, as in the case of the land-tax and income-tax.[1]

[1] The proceeds of the direct taxes collected by the Commonwealth during 1926–27 were divided between it and the States as follows:—

(£ 000's omitted).

| | Total | Commonwealth | States |
|---|---|---|---|
| Land-tax | 2,311 | 200 | 2 111 |
| Income-tax | 10,506 | 6,450 | 4,056 |
| Estate duty | 1,350 | 50 | 1,300 |
| Entertainments tax | 370 | 50 | 320 |
| | 14,537 | 6,750 | 7,787 |

The amounts credited to the Commonwealth, under estate duty and entertainments tax, represent the arrears of assessment of the previous year. The assessments for 1926–27 were to be handed over to the States. (*L.O.N.M.*)

This arrangement has made it possible to discontinue the grant of the capitation allowance of 25 shillings to the States, though Tasmania and Western Australia, which have, since 1910, received special subsidies, received assistance to the extent of £450,000 and £378,000, respectively, on account of special difficulties and disadvantages.

This administrative centralization has been accompanied by another important development. The Commonwealth has taken over all the existing debts of the States; and for future loans the Australian Loans Council, consisting of the Treasurers of the Commonwealth and the States, created in 1924, is to determine the order in which the Commonwealth, the States and the various public bodies created by the State Legislatures shall come upon the Australian market. The Council has already been acting as the central borrowing authority, and the loan operations both of the Commonwealth and the States have been conducted in accordance with the plans adopted by it. The borrowing in New York and in London is now conducted solely by the Commonwealth, and the loans floated under the new arrangements have been a great success. The Commonwealth has assumed liability for interest on State debts to an amount of £7,585,000, and will contribute towards the sinking fund of the existing debts at the rate of 2*s*. 6*d*. per cent per annum; and all new debts created by the States are to be paid off through a sinking fund of 10*s*. per cent per annum, of which the Commonwealth will contribute 5*s*. The subventions of the Commonwealth towards the interest on State Debts and the sinking funds of their old and new debts will in the aggregate be larger than under the *per capita* system. The discontinuance of the capitation grant, therefore, has led only to its being replaced by another calculated on a different basis. The States will still receive substantial assistance from the federal exchequer. Instead of receiving an assignment for general expenditure, they will receive a grant for the payment of interest on public debt and the repayment of the debts themselves. Moreover the establishment of the Loans Council and the flotation of loans according to its plans will be a great advantage all round.

Under section 9 of the Constitution, the Commonwealth is authorized to grant financial assistance to any State on such terms and conditions as Parliament may think fit. It grants a subsidy of £15,000 per annum to the various States for the treatment of venereal diseases, and is also performing the function of co-ordination in a number of other ways.

The creation of a central tax-collecting and borrowing authority is a milestone on the path of financial co-ordination. It is a recognition of the need of providing against conflicts of authority, duplication of efforts and undue competition in the fields of borrowing and taxation. There is great reluctance to adopt any measures which might be construed as implying any derogation of the dignity of the States on the one hand, or any abdication of the unrestricted authority of the Commonwealth to impose and collect taxation on the other. It is not easy to break the old moulds; and progress towards a better adjustment of financial relations is slow, and in some respects halting. But, as remarked above, a move in the right direction has commenced, and is likely to continue, gaining in effectiveness and momentum with the passage of time.

### *South Africa*

South Africa is hardly a federation. Officially it is called a 'legislative union'. Despite the fact that prior to 1910 the territories now included in the Union were dominated by particularistic tendencies, the Central Government in South Africa is all-powerful, and the Provinces have only limited powers of legislation and administration. Natal has not altogether reconciled itself to the supremacy of the Union Government; but the other three Provinces regard the fact as an element of strength, and do not find the restrictions under which they have to conduct their administration specially irksome. In financial matters the Central Government is, if anything, even more powerful. The Provinces have extremely limited powers of taxation. The bulk of their revenue is derived from sources administered by the Central Government or assignments. The Union is in exclusive control of all

the important sources of revenue. But even so it is worth while for students of federal finance to know something about its finances. The unity, which is the basis and the purpose of the South African Constitution, has had to be evolved, and was not there in the past; and the process of evolution is not yet complete. Central administration is now an economic necessity, and most of the taxes have of necessity to be assessed and collected by the Union; but the problem of the twentieth century is to discover methods by which it may be possible for the constituent units of a federation to develop their own life without introducing local anarchy in the administration of finances. This has to be done in all countries which are, or are aspiring to be, federations; and complete success has not been achieved anywhere as yet. South Africa is also in a state of transition. It has secured the initial advantage of having established constitutional unity. It has still to make it a living fact; but once that has been done, it will have to enlarge the powers and resources of the Provinces. The Union of South Africa can never be a political merger. It will be necessary to pool the achievements of the different Provinces, and remain united for common ends; but that can be done on the basis of functional and, therefore, financial autonomy. Its finances even now are instinct with a purpose which can only be described as federal; and with the development of its latent tendencies, the financial system will appproximate more and more to the modern federal ideal. A brief outline of the existing arrangements may, therefore, be attempted.

The constitution of the Union did not define the financial relations of the Union and Provincial Governments during the years 1910 to 1913. When the Financial Relations Act came into operation, the funds required by the Provinces were provided by grants from the Union exchequer. A provision was made therein for the appointment of the Financial Relations Commission, whose report was made the basis of the Act of 1913. Under it all the important sources of revenue like customs, excise, mining revenues, succession duties and income-tax were reserved to the Union Government.

They were administered by that Government and all receipts go to the Union treasury. The revenue from the transfer duty on fixed property, licences for the sale or supply of liquor and native pass fees were collected by the Union Government; but, instead of being credited to the Consolidated Revenue Fund, were paid over to the Province in which they were collected. The average revenue of the Union Government from 1910–11 to 1914–15 was £15·8 millions, and the provincial revenue only £1·2 millions. In 1922–23 the central revenue amounted to £27·25 millions and the provincial to £3·5 millions.[1] The Union Government has had, and still has, an undivided control over the bulk of the total revenues of the Union.

The Provinces were to derive their revenues from assignments from the Union exchequer, revenue transferred or assigned to them, and taxation which they levied by virtue of their taxing powers under the constitution. These powers were limited, and the taxes which the Provinces could impose were specified. The principal taxes which they imposed under their own authority were an amusements tax, tax on totalizators, vehicle tax, house-tax and a tax on immovable property. The receipts of the three taxes mentioned in the preceding paragraph were assigned to them. But they relied mainly upon subsidies from the Union for their funds. The Act of 1913 provided for a subsidy from Union funds for one-half of their normal and recurrent expenditure; but later on these grants were made subject to some limitation as regards the annual increase in such expenditure, as it was felt that the Provinces were expanding their expenditure at a rate which was neither justified by their needs nor by the growth of the revenues of the Union. A special subsidy of £100,000 each was granted to Natal and the Orange Free State, in view of the fact that the funds otherwise placed at their disposal were insufficient to balance the initial expenditure of these Provinces. It was specially provided that the expenditure incurred by certain local bodies should be included in the ordinary

[1] *Official Year Book of the Union of South Africa*, 1910–24.

expenditure of the Provinces, for the purpose of assessing the subsidy, in order to put the Cape Province on terms of equality, financially, with other Provinces, since its provincial services were largely carried out and paid for by the subsidiary local authorities. In 1922–23 the subsidies of the Union Government amounted to £4 millions, having risen to that figure from an average of £2·8 millions for the years 1910–11 to 1914–15. As the total revenue of the Provinces for that year was £3·5 millions, these subsidies accounted for more than half of their total receipts. In Natal and the Orange Free State the Union subsidies, general and special, amounted to £563,032 and £577,408, respectively, out of total receipts of £976,251 and £940,827.[1]

In September 1922 a Commission was appointed to enquire into and report upon the finances of the Provinces. This Commission is known as the Baxter Commission, after the name of its President, Mr. W. O. Baxter. The Commission condemned the system of subsidies to the Provinces on the pound for pound basis, pointed out that the growth of expenditure on certain heads, and particularly on education, had been excessive, recommended certain sources of revenue as appropriate to Provincial administration, and was of opinion that the sources of revenue open to the Provinces should be clearly defined and limited, and should be enumerated in an Act of Parliament as their only sources of revenue. They also recommended that a general survey of the four Provinces should be made with a view to drawing up a programme of capital expenditure. For the economical administration of the country, there should be more co-operation between the Union Government Departments and the Provincial Administrations, and local authorities with financial responsibility should be developed. As a result of their recommendations, in 1925 a new Act was passed to regulate the financial relations between the Union and the constituent Provinces. The system of subsidies has been changed; and now they will be distributed on the basis of the number of pupils attending the schools in the

[1] *Official Year Book of the Union of South Africa*, 1910–24.

Provinces, and the method to be employed in preparing educational statistics is to be laid down by the Union Government. The taxes which the Provinces can impose are specified, and include, besides an amusements tax, auction duties, taxes on betting, a tax on immovable property, taxes on personal income, and taxes on companies, other than mutual life insurance companies; but are subject to certain limits laid down in the Act. The object of the measure is to promote greater co-ordination, and to bring home to the Provinces their own financial responsibility for the administration of the functions assigned to them. The Provincial subsidies till 1922–23 were really subventions, being half the provincial expenditure; but the Union Government had no power to regulate this expenditure or its growth. Now it will be possible for them to make the subsidies proportionate to the school enrolment and to adjust them to the needs of the Provinces without impairing the financial authority of the latter. They will now be more like assignments, though they will be granted on the basis of educational statistics. The change is certainly an improvement, and will increase the efficiency of financial administration in South Africa.

This account of the system of public finance of eleven federal States, in all cases brief and in some necessarily fragmentary, may now be concluded with a few general observations. What have the successes and the failures of these systems to teach us? A great deal, if we are only willing to learn. The first and the most obvious fact, the importance of which has to be appreciated, is that all these federal States are, in respect of their financial relations with the constituent units, passing through what may be called a twilight period. This is due to two reasons. The first is that the growing unity of economic life has made local boundaries unimportant; and indeed they are now obstructions in the way of a more efficient organization of economic life. In the fiscal sphere this development has changed the base of assessment and administration, and has given rise to the necessity of a central control

of direct and indirect taxes. The coalescence of different parts of every country into one economic whole renders it difficult to carry on their administration on the assumption that each part should have its own orbit of political life and fiscal activities. Railways, ramifying enterprises, and the dispersion of economic interests have necessitated a re-orientation of the whole policy of the federal Governments. They must still be in charge of functions which are common to the whole nation, 'either because all the parts of the nation are alike interested in them, or because it is by the nation as a whole that they can be satisfactorily undertaken.'[1] But the integration of economic life has increased the number and importance of the functions in which all the parts of the nation are alike interested, and also of those which can only be satisfactorily undertaken by the nation as a whole. It is not sufficient that the federal Governments should be responsible for national defence and the regulation of commerce. They have to assume responsibility for guidance, supervision and even control in many new spheres, and cannot remain passive when the needs of the times call for concerted action in so many directions. The other reason, which accounts for the change that is coming, is that the quickened social consciousness of the people requires that the nation should rise to a higher level of creative activity. In matters relating to education, public health and social policies, there is a demand for the attainment and maintenance of a national minimum of efficiency and progress. The federal Governments have had to undertake numerous cultural and economic functions which, fifty years ago, would have been regarded as the sole concern of the constituent states. The joint result of the working of these factors is that the necessity of financial re-adjustments has become imperative, and they are being made in all federal states. But it is not possible to make them without disturbing old prejudices and long-established traditions. The American Constitution was framed in 1787, and its fathers could not possibly have envisaged the developments that have

[1] Bryce, *American Commonwealth*, p. 33.

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[1] Bryce, *American Commonwealth*, p. 33.

taken place since then. The constitutions of other federal states are more recent, but the ideas implicit in them are not always in harmony with the needs and ideals of the times. Most of them aim at a balance of powers, and an attempt to put them to unaccustomed uses is producing internal stresses and strains of varying degrees. The new constitutions, framed after the war, avoid the pitfall of a rigid demarcation of spheres, but have still to find their own moorings. Their difficulties are due to the necessity of making adequate provision for constructive initiative on the part of the component parts of the federation without undermining the efficiency of the national life as a whole. The two extremes of local anarchy and local atrophy have to be provided against. There is a middle path, but it is not easy to find it. The result is uncertainty all round. Tentative plans, experimental measures, provisional schemes have had to be adopted in order to find a new and stable basis for financial relations in federal states. There is no doubt that one chapter in the history of federal finance has been closed. It was related to the federalism of powers, which is now a thing of the past. But another has not been definitely opened as yet. It belongs to the federalism of functions, which in its fullness has still to be inaugurated. It is already there, and must be regarded as a formative factor of great potency, but it has not crystallized into a political creed as yet. It has to find its own mechanism, develop its own technique and forge its own instruments for the realization of its purposes. That will take time. In the history of nations there are no wild bells to ring out the slowly dying causes, and ring in the things to be all at once. There is always what H. G. Wells would call 'the meanwhile'—the period of anticipations, of trial and error, of new modes of thought and action. In federal finance things are in a state of flux. We are passing through a stage of re-adjustments. There is, therefore, a great deal of confusion and uncertainty; but there is also an ever-increasing understanding of the purpose which has to be realized. Whatever we may do in India, it is hoped that we shall not commit the error of giving any finality to our financial settlement. Besides the conditions peculiar

to India, which suggest the need of our adopting only provisional measures, the working of world factors points to the necessity of not incurring any commitments which may make future adaptations a matter of difficulty. The financial settlement must be flexible, if it is to satisfy our special needs; and it must be in keeping with the tendencies that are in operation everywhere.

Administrative centralization in the fiscal sphere, which is proceeding apace in so many countries, is the direct outcome of the working of these forces. It is complete in Germany, Austria, South Africa and Russia, and its need is being felt in other countries. In Australia unity in the principles and rates of assessment has still to be achieved; but a central assessing and collecting authority has been established. The importance of the central control of customs and excise duties has been appreciated ever since the inauguration of the American Constitution. The fact that, in almost all federal constitutions, the federal Governments are invested with exclusive jurisdiction over these taxes is clear evidence of the inherent necessity of centralizing their administration. But now it is being realized more and more that a conflict of jurisdictions due to the decentralized administration of direct taxes is a serious inconvenience, and can be put an end to only by doing away with such decentralization; and it is also obvious that this end cannot be achieved without giving to the central Government full authority over the assessment and collection of the direct taxes which are imposed on 'objects' of national importance. In 1919 the Commonwealth of Australia made an offer to the States to collect their direct taxes at one-third of the cost which was being incurred by them. This offer was followed by a counter-offer by the Treasurer of the State of Victoria in these words: 'I am prepared to offer that Victoria will collect your (Commonwealth) taxation, in Victoria, at half what it is costing you at the present time.'[1] The Commonwealth Treasurer replied: 'I have thought it over, and I rejected it for reasons explained to the House of

[1] *Second Report of the Australian Royal Commission on Taxation*, p. 71.

Representatives;' and the most important reason given for the rejection was that, while it was possible for the federal machinery to be mobilized and organized so that the State machinery might disappear, it was impossible to administer through State agency a graduated tax on persons who did business in many States and derived income from diverse and widely scattered sources. The answer was conclusive; and after giving a trial to a method which admitted of both the Federal and State taxation officers having a hand in the administration of direct taxes, it was decided in 1926 that their administrative control should be taken over by the Commonwealth. This is the only way in which the evil arising from a clash of competing jurisdictions can be remedied. The fact that direct taxes, at varying rates, are being assessed and collected independently by the State and Federal authorities in the United States, Canada, Switzerland and some other federal States is no argument against administrative centralization. Constitutional theory and practice in these countries have not kept pace with changing circumstances; and the makeshift devices adopted there, to get over the difficulties created by 'the possible combinations which are terrifying in their complexity', only show that it is the past which is an obstacle in the way of fiscal reform. A country, whose own past presents such formidable difficulties and in so many directions, can ill afford to let the past of other countries be a determining factor in its financial re-adjustments.

The necessity of administrative centralization leads to another result which follows it 'as night the day'. If all important taxes, direct and indirect, are to be under the legislative and administrative control of the central authorities, there cannot be a 'genuine and complete separation of resources'; or to use the terminology of Dr. Hensel, the 'object' sovereignty and 'produce' sovereignty cannot be vested in the same authority. If the federal Government is to administer customs, excise, income-tax, the inheritance tax and sales tax, it cannot be allowed to appropriate their entire yield. There must be a division of receipts. There are different methods by

which this can be done. Some of them will be discussed in the next chapter. Apportionment of yield brings several complications in its train, and it is not possible to eliminate the element of arbitrariness from it altogether. It is much simpler to have a segregation of resources and functions, a financial and administrative clean cut. But the conditions of the world are not simple to-day, and simple solutions of complex problems do not fit in with existing facts. Each Government ought to be assigned the sources which are appropriate to its administration. But it is impossible to ensure that they will yield it revenues adequate, and no more than adequate, for its needs; and as most sources of taxation are appropriate to the central administration, it is inevitable that the states or provinces should receive a large portion of their receipts from taxes which they are not in a position to administer or control themselves. Social surplus has now become an all-important element in the income of individuals and groups. Organization and conjuncture count for so much, and the isolated efforts of the individual for so little, that it is difficult to allocate to each his contribution to the common heap. This is why a national minimum wage-fixing machinery has been introduced in so many countries, and why family allowances and maternity endowments are acquiring such a great vogue. The same considerations apply to political authorities, whose jurisdiction is not co-extensive with the entire economic life of a nation. It is very difficult to say how far the incidence of taxation rests on those on whose political allegiance they may be considered to have a prior claim, and how far the incomes of such persons can be credited to their public account. There has to be a central administration of taxes and an apportionment of their yield on an equitable basis. Equity is an object which it is extremely difficult to realize. But the difficulty is rooted in the facts of economic life; and we have to do the best that we can under the circumstances to secure an equitable distribution of resources. This, however, cannot be done by combining the 'object' and 'produce' sovereignty of taxes in the same authority.

The same factors also account for the contributions

paid by the federal Governments to the state authorities, which are such a common feature of federal finance all over the world. Payments corresponding to our Provincial contributions are practically non-existent. The matricular contributions in Germany disappeared in 1919; and would have disappeared, as already stated, in 1879 if political considerations had not come in the way. In Switzerland the Federal Government has the constitutional right to impose contributions on the Cantons; but the right has fallen into disuse, and is now only a rusty and ineffective weapon in the fiscal armoury of the Swiss Federation. A federal Government ought to possess an overriding power in the case of war and disasters of the same magnitude; but as a normal feature of the financial settlement of federal states, contributions by the states to the federal exchequer have no claim to serious consideration. But contributions from the central treasury are found in almost all federal states, and they are likely to remain an important characteristic of their financial settlements. There are differences both of kind and degree in these payments, which are important and significant. It is necessary to distinguish them from each other, and to use different words for each, though in practice these distinctions are generally overlooked. The first in order of importance are what we have called assignments, the amounts credited to state or provincial treasuries under the terms of an agreement. They accrue to the states or provinces as a matter of right, and do not involve any control of their policy or administration by the federal Government. The revenues handed over to the States by the Reich in Germany, the *per capita* allowance in Canada under the Act of 1907, and in Australia under that of 1910, come under this category. The so-called subsidies in South Africa, granted as a share of the normal and recurrent expenditure of the Provinces till 1925, though not quite on a par with these payments, are also assignments. They had to be abandoned on account of a disproportionately rapid growth of Provincial expenditure; but the Provinces had a claim to them not as a matter of grace but of right. These assignments are necessary on account of the

Federal Government having the administrative control of revenues which are more than sufficient for their needs. They are a means of division of the yield of taxes ; and, as stated in the preceding paragraph, are inevitable in the existing circumstances. In the second place, there are grants for specific purposes, which, however, do not carry with them any material curtailment of the autonomy or powers of the States or the Provinces. The specific grants to meet the expenses of Provincial Governments in Canada, the payments according to the number of pupils on the rolls in South Africa, and the new grants towards interest charges and sinking funds in Australia belong to a class by itself. Being given for specific purposes, they are more like the grants referred to below ; but as they do not circumscribe the financial powers of the constituent States, they partake of the character of assignments. It is not possible to suggest that the States in Australia or the Provinces in South Africa are less autonomous than they would be otherwise because the former receive a contribution from the Commonwealth towards their interest charges and sinking funds, and the latter receive grants from the Union Government in proportion to the number of pupils on the rolls. In spite of their superficial resemblance to grants which do involve central control, they must be differentiated from the latter. In the terminology of finance they have not been given a distinctive name, and may, for want of a better term, be called subsidies. In the third place, there are grants-in-aid for specific purposes which are paid, subject to definite conditions as regards the objects and manner of their expenditure, and entail an inspection and supervision of the State or Provincial administration by officers of the Federal Government. The federal grants in the United States for vocational education, hygiene and highways, in Switzerland for numerous objects of social utility, in Germany for specific appropriations, in Canada for highways and for technical and agricultural education, and in Australia for venereal diseases, are of this description. They are paid either because the constituent States have to undertake 'national',

and therefore 'onerous', functions or because they need an impetus for embarking upon certain desirable activities, and get it in the form of monetary assistance from the Federal Governments. These grants are, to use the words of Sidney Webb, 'the necessary hinge in the flap.' Federal Governments have now to enlist the co-operation of the States or Provinces for promoting objects of national importance; and their ability to back their invitation to the latter to participate in the realization of these objects with a conditional offer of pecuniary aid makes the States more responsive to this call from the centre, and also more willing to submit to central direction. These grants may be called subventions, and their centralizing intent and purpose must be admitted. It is, however, to be noted that in most cases their object is to promote co-ordination and not to establish control. The line which divides co-ordination from control cannot be clearly drawn; and in practice a great deal has to be left to the good sense of the administrative authorities. But in a federal state the independent status enjoyed by the states or provinces is a great safeguard against their being used to sap the autonomy of the latter. They have their own legislatures, their own administrative machinery, and their own resources; and the success of policies introduced on the initiative of the federal authorities depends upon the willing and even enthusiastic co-operation of the constituent states, which cannot of course be forced from above. In India it is not easy to appreciate this point on account of the deadening effect of years of centralization; but, in federal states with a well-developed political life, even the subventions need not be a menace to the political autonomy of the states or provinces. They are only the means by which the urgent need of co-ordination is satisfied. Assignments, subsidies and subventions are the three forms in which the federal Government makes payments to the states or provinces; and though the distinction between them is not always clear-cut, it is of great practical importance. These payments are likely to remain a permanent feature of systems of federal finance, and may be further developed owing to the facilities which they afford for the

apportionment of funds and the co-ordination of activities of common interest and importance. These grants-in-aid have been acclaimed by eminent thinkers as an instrument pre-eminently suited to the needs of modern democracies. Prophecy is rash when we are moving so fast, but it is not improbable that in the further elaboration of assignments, subsidies and subventions the federation of the future will find a convenient and adequate method of evolving unities out of enduring differences. That is, however, a matter for the future and therefore uncertain; but it is clear that contributions from the federal Governments to the states or provinces are a normal feature of almost all federal constitutions.

It is also noteworthy that special grants to particular states are not uncommon, and their necessity is taken for granted. Such grants have been given to the Western States in the United States, to British Columbia and Prince Edward Island in Canada, to the Orange Free State and Natal in South Africa, and to Tasmania and Western Australia in Australia. They are given because of the special difficulties and disadvantages of the states or provinces concerned, and their amounts are determined by the needs of the recipients. They are in the nature of assignments, and the states receiving them are not subjected to a larger degree of central control owing to the special assistance to which they are considered entitled on account of their special needs.

The Taxation Enquiry Committee remarked that there was no federal state in which the distribution of the taxes between the federation and the states that composed it was based upon considerations of pure theory. This is so, and there is no objective standard for the allocation of resources. The conditions of the problem differ so widely that its solution has to depend mainly upon considerations of expediency. But it is likely that the re-adjustments, which are in progress in all countries, will make the fiscal inter-relations of different political authorities less essentially dissimilar in the future; and there will be a tendency to assimilate to the same ideal

and to express the same purpose. There are not and cannot be any ultimate values in federal finance; but as Burke said, 'The revenue of the State is the State. In effect all depends upon it, whether for support or for reformation;' and the reconstruction, which is now a world-wide phenomenon, will, because it is prompted by the same forces, produce similar effects upon the fiscal systems of different countries.

## CHAPTER VI

### *The Re-allocation of Resources*

We have now come to a point at which it is possible to turn to the problem of reconstruction in the immediate future. Reconstruction has to proceed on many lines, but the redistribution of revenues is of primary importance, and will cause the greatest difficulty. There is a general agreement of opinions as to what has to be done. The country is in an extremely backward condition, and cannot take its rightful place in the comity of nations without the fullest possible development of its material and moral resources. Political freedom is an essential and preliminary condition of realizing this object, because we cannot rise to the height of our possibilities without self-confidence and self-respect, which that alone can give. But political freedom cannot be turned to the best account unless the nation is equipped with an adequate and efficient organization, and knows how to use it. Financial reconstruction, being an integral part of the general reconstruction of our national life, has to provide conditions necessary for the attainment of a high level of development and progress. Its aim, as that of all other measures of reform, should be to open new avenues for organized activities and to utilize fully those which are already there. Finance is not mere political arithmetic, it is the science of national economy ; and the utility of its formative side depends upon its discovering opportunities for constructive enterprise and fresh adventures in the field of concerted efforts. This is the practical aspect of the problem of federal finance ; and there cannot be any doubt or dispute regarding its supreme importance.

For the full development of our national life we require almost unlimited fiscal resources. The needs, which have to be satisfied, are so many and so urgent

that even the utmost expansion of the public revenues will fall short of the barest minimum which it is necessary to provide. It has been estimated that a scheme of free and compulsory mass education will, if it is to be put into operation, cost about Rs. 60 crores. This is a need about the urgency and importance of which there cannot be any difference of opinion. There are many others, which are equally pressing, and for which an enormous amount of money will be needed. The provision of the civic minimum for one-fifth of the human race cannot but be a very costly undertaking. It is impossible to find all the money that will be required for the purpose; and for a very long time to come we shall have to give precedence to those public wants which must be first satisfied before others are attended to. But even then it will be absolutely necessary to develop our fiscal resources as much and as fast as we can, if we are to have the satisfaction of feeling that we have done our best. This, of course, means that additional taxation will have to be imposed; and the prevalent belief that the limit of our taxable capacity has already been reached, if not exceeded, will have to be given up. The limit of taxable capacity is conditioned by the purpose for which the yield of taxation is used; and, given the will, it ought to be possible to increase the supply of funds for beneficent activities. There is need of and room for economy in every direction. We shall have to acquire the habit of going without a number of costly luxuries to which we have become accustomed under foreign rule. A poor country has to make the most of its limited resources, and must use every pie to the best advantage. Economy ought to be our most important source of revenue. But even if we were free to introduce all the measures of economy which we consider necessary, we shall not be able to save amounts large enough to finance even a small fraction of our needs; and if we raise the salaries of the subordinate public employees, who are, as is well known, extremely ill-paid, the funds, which even the most rigorous measures of economy can make available for development, will be utterly inadequate even for our most urgent reforms. Moreover, one elementary fact of the present

situation has also to be borne in mind, viz., that political conditions render it impossible for us to enforce economy in the directions in which it is most needed, and the possibility of our adding much to our public revenues is still further limited on that account. It is, of course, not suggested that we should acquiesce in the present order of things, or cease to protest against the wasteful and disproportionately high scale of expenditure which has been set up in India. We must introduce an Indian scale of expenditure, and make use of all the political power which we possess and may acquire to bring home to the public authorities the need for the most rigid economy in our administration. Our experience, since the Reforms, shows that the need of extreme vigilance against the extravagant demands of the Indian element in our public services is even greater than in the case of the non-Indian personnel. The latter will be with us for some time to come, but must now be treated as a factor of decreasing importance. The former, however, we shall have with us for all time; and once entrenched in a position of power and authority, they will make a dead set against all efforts that may be made later on to reduce the scale of salaries of the higher services. There is need, therefore, for the utmost vigilance in this matter; and we must do our utmost to build up new and better traditions in the public expenditure of the country. But the facts of the situation must be faced. There are certain things which are not possible in the immediate future, and it will be folly to act as if they were; and one among them is that the scale of expenditure cannot be appreciably reduced for years to come. It is no use insisting that the greatest possible economy must precede additional taxation for financing the development of our resources, when we know that the former, besides not being possible, cannot take us very far, and that without the latter we have to face the alternative of complete stagnation in our national life.

We have, as a matter of fact, to change our whole attitude towards taxation, and accept fully the obligations of our coming freedom. Our political subjection has fostered in us a belief that taxation is a necessary evil,

and that there is no point below which it is not right to reduce it. This negative view of taxation is not confined to India, but it is more potent here owing to the absence of political freedom. It has to be abandoned, if we want to create an atmosphere which may stimulate us to intellectual endeavours worthy of the citizens of a free state. The general attitude towards taxation has undergone a change everywhere in the last generation; and it is, to quote the words of Professor Seligman, 'no longer regarded as a burden to be exacted from the unwilling victim, but as a contribution cheerfully rendered by those who are alive to a sense of collective responsibility implicit in the very conception of democracy'. Another factor, which has brought about this change and is closely related to the first, is that it is realized that public expenditure in most cases means better economy for the nation than an equivalent amount of expenditure by individual citizens, and, therefore, additional taxation is to be welcomed as a means of diverting national resources from individual to collective channels. We have to develop that 'sense of collective responsibility implicit in the very conception of democracy', and to realize the importance of taxation as a method of utilizing the total income of the community to the greatest advantage. This change has to come if we are to discharge the civic duties which our new civic rights will bring with them. The Meston Committee considered it an unthinkable sequel to the administrative changes introduced by the Reforms that they should be followed by measures of additional taxation. They were right from their own point of view, but now we must adopt a different standpoint. The best thing that can happen to India, after the introduction of the new constitution, is that there should be a general movement towards raising the level of Central, Provincial and local taxation, with a view to provide the country with the amenities of a progressive and up-to-date administration. It will be the most conclusive evidence of the determined purpose of our people to embark upon our new freedom with a full understanding of its responsibilities. But this consummation, howsoever devoutly we may wish for it, cannot take place

for years to come ; and a long period of political education must elapse before the people learn to appreciate the true character and importance of taxation. Yet it is certain that we cannot afford to reduce taxation in the near future, and the talk of doing our duty by the general tax-payer is utterly beside the point ; and this is so in spite of the fact that our present system of taxation is extremely regressive, and the need of giving relief to the poorer classes, which, of course, means the bulk of the community, is great and pressing. There is no country in the world in which the state takes away from one-third to one-half of the net profits of cultivators, owning three to five acres of land and in most cases less, and also taxes them through customs, excise, salt, fees and public utilities. Our people are heavily taxed, but still the best way of giving them relief is to change the incidence of the benefits of expenditure and not to reduce the taxation itself. It is, of course, a necessary corollary of this line of reasoning that the richer classes must be made to carry much heavier fiscal burdens, and the principle of progression and differentiation more fully developed in our tax system. The inequalities of incomes in India are even more glaring than in other countries, and it is in the interests both of fiscal and social equity that the upper ten should be required to contribute much more than they do at present to the public exchequer. There is, therefore, no prospect of reducing taxation ; and it ought, if possible, to be raised with the willing consent of the accredited representatives of the people.

It was necessary to emphasize the necessity of additional taxation as it is generally assumed that one of the first uses to which we ought to put our political freedom is to reduce the existing level of taxation. This is a false hope which we have been holding out to ourselves, and the sooner we give it up, the better. Some re-adjustments will, of course, have to be made ; but, on the whole, the level of taxation has to be raised, and the distribution of its burden can be made less regressive only within very narrow limits. That, however, does not affect the necessity of the re-allocation of resources. In the first

chapter, the principles which ought to guide us in making fiscal re-adjustments between the Central and Provincial Governments were enunciated. They may be briefly stated again. The integrity of the system of taxation must be safeguarded. The problem of taxation must be viewed as a whole, and the allocation of resources must not undermine the federal spirit, which implies that the ends of unity and autonomy must both be adequately provided for, and that measures must be adopted for the prevention of the serious evil of the conflict of jurisdictions. A scheme of re-allocation of resources, to be of any use, must be capable of early application. It must respect the facts as they are, but should also be designed to meet the need of changes that may have to be introduced in the interests of harmony and efficiency. It should be based on a large measure of general consent, and give adequate revenues both to the Central and Provincial Governments. The Central Government should have funds to discharge its duties in respect of national defence, regulation of commerce and co-ordination of functions of national importance; and the Provincial Governments should, of course, have large and buoyant resources for the progressive development of the functions assigned to them. The basic feature of the scheme must be that each authority should be placed in charge of the taxes which appropriately belong to it, and the adjustments necessary to provide adequate revenues to all Governments made by a suitable apportionment of their yield. To these principles may be added another, which is of special importance under the peculiar circumstances of India. The scheme must make provision for the rectification of the old and long-standing inequalities among the Provinces. This point has already been dealt with in almost wearisome detail, and it is not necessary to labour it further. The Government of India must assume the obligation of making some amends for the neglect of this duty in the past.

The consideration, then which is of paramount importance is that each Government must have assigned to it the sources of revenue which are appropriate to its own administration. The question of re-allocation of resources

may first be discussed in the light of this consideration. There are certain sources of revenue about the allocation of which there is not any room for difference of opinion. These can be easily disposed of. They are of customs, revenue excises, salt and land revenue. Of these the first three must be administered by the Central Government, and the fourth by the Provincial Governments. Customs are in all federal states reserved to the Central Government; and as a number of federations are the outgrowth of a customs union, or were created to establish uniformity of tariffs, a federation without the centralization of customs is unthinkable. In Brazil, export duties are imposed by the Provinces; but as very little is known about the practical effect of this allocation, it may be assumed that the experience of all countries and ordinary commonsense are in favour of the Provinces being precluded from having anything to do with the determination of the policy and rates of customs duties or with their assessment and collection. It may be possible to allow the Provinces, or some of them, to appropriate the yield of export duties; but that is a different matter, and will be dealt with in the next chapter. The same considerations hold good in the case of revenue excises and the salt-tax. The latter is partly a customs and partly an excise duty, and has to be administered according to the principles applicable to both. Excise duties are also exclusively imposed by all federal Governments; and the necessity of this provision arises from the impossibility of preserving the economic unity of a country or inter-State harmony without it. No Province can be permitted to create impediments in the way of the freedom of internal trade; and the imposition of excise duties must, therefore, be the sole concern of the Government of India. This ought to be true of all excises, both revenue and restrictive; but the case of restrictive excise duties has some special features of its own, and must be considered by itself. The revenue derived from the export of opium will, of course, remain a Central receipt for a few years more till its export is stopped altogether as a result of the fulfilment of the international obligations assumed by the Government of India.

The land revenue should go to the Provinces. It is an anachronism, and cannot be given a place in the fiscal system of a country which wants to re-model its taxation in accordance with the principles of fiscal science. But very few countries are in that happy position, and India is not one of them. This archaic tax has, therefore, to be with us for a long time yet. It is full of anomalies and contradictions, the removal of which will take a long time. The incidence and effects of land-revenue not only vary from Province to Province, but also from district to district in the same Province ; and in spite of voluminous codes and elaborate regulations the assessment is in most cases made on the basis of nebulous and hypothetical data, and the process gives free play to subjective factors. In Provinces like Bengal and Bihar, its yield is absolutely fixed ; and in other Provinces conditions of rigidity are supervening with a rapidity which augurs ill for the future. Its administration is practically a part of district administration ; and through it the district officers are brought into contact with the every-day life of the people. These considerations make it *par excellence* a Provincial head ; and it is not possible to think of any arrangement under which it can be administered by the Government of India. The land-tax in Australia is now being assessed and collected by the Commonwealth ; but in all other countries the tax on land and fixed property is administered by the State or the local authorities, and its suitability for local purposes is beyond question. Land revenue in India must, therefore, remain a Provincial head.

There are four other sources of revenue which ought to remain Provincial. Irrigation is a semi-commercial undertaking, and its fiscal importance in some Provinces is considerable. Its administration is now closely connected with the land-revenue administration ; and the charge levied for water is, over a large area, merged in the land-revenue demand. It is a bad combination, and makes it extremely difficult to say whether all the revenue credited to irrigation is really due to it, for the manner in which receipts, due to irrigation, are differentiated from the land revenue proper is arbitrary in the

extreme, and from the point of view of sound accountancy these charges present almost insoluble problems. The amalgamation of the two is an act of folly for which the Government of India are responsible, and is to be explained by their having lost sight of the essential differences between them in their desire to introduce a convenient arrangement from the administrative standpoint. The result is that what is really a public price has come to be regarded as a tax; and it is becoming increasingly difficult to charge the full value for the water supplied to the agriculturists, which means that the latter are being supplied at the expense of the general taxpayer. All this is unfortunate, but cannot now be helped; and it is necessary that irrigation should also be administered by the Provincial Governments.

This will give rise to certain difficulties and complications, for, as the Agricultural Commission has said, 'rivers and drainage lines do not respect Provincial boundaries,'[1] and the need of settling differences between the Provinces, and between the Provinces and the States, has already arisen and is to be regarded as a recurrent possibility. The Thal project has had to be practically abandoned on account of the differences between the Governments of Bombay and the Punjab, and the execution of important irrigation works like the Kistna and Tungabhadra projects and the scheme of the Woolar Lake as a storage reservoir have had to be postponed owing to the failure to reach an agreement with the Hyderabad and the Kashmir States. The dispute between the Mysore State and the Madras Government regarding the Cauvery project is now before an arbitration board. Apart from these initial difficulties, which will require action on the part of the Central authorities, the administration of irrigation will, in certain cases, necessitate the adoption of a common policy and a common organization by otherwise autonomous units of the federation. The Sutlej Valley project, to give an illustration, will, when completed in 1933–34, provide perennial irrigation to two million acres, out of

[1] *The Agricultural Commission Report*, p. 348.

which a million and a half acres will be in the Bahawalpur and Bikanir States; and it will, therefore, be necessary for the Punjab Government and these States to pursue an agreed policy and maintain a common agency for the administration of this important irrigation work. The Provincial administration of irrigation will thus be attended with some difficulties, and it will be necessary to provide for a certain measure of Central co-ordination and even control. But, as already remarked, past commitments make it necessary to administer irrigation works on a Provincial basis; though even if these were not there, it would probably be more convenient to entrust their management to the Provinces with an adequate arrangement for preventing friction between the different Governments. In any case there is now no room for a choice in the matter, and irrigation has to be made a Provincial subject.

Forests are of very great importance as a valuable public estate, and can be developed to increase the public revenues; but at present their receipts are important for fiscal purposes in only some Provinces. Out of a total net income of Rs. 2·64 crores[1] from forests in India in 1926–27, Burma's share was Rs. 1·47 crores; and Bombay, which came next to Burma in this respect, realized net receipts of only Rs. 33 lacs. In Assam also the receipts from forests are important for the Provincial exchequer, and have increased from Rs. 3 lacs in 1921–22 to Rs. 17 lacs in 1926–27. The forest receipts of the Central Provinces have not been growing, but they account for about 3 per cent of its total revenue. In other Provinces the proportion of forest receipts to total revenue is much smaller; and in Bihar and Orissa the forest department is to be regarded as a spending department. The variations in net receipts show the importance of local factors in the operation of forests, and are also indicative of the fact that forests are a field in which Provincial enterprise can find free scope. It will be necessary to devise safeguards against a

[1] *Annual Return of Statistics relating to Forest Administration in British India for the year 1926–27*, Statement xix, page 31.

particular Province charging a monopoly price for forest products, some of which may be important raw materials of industry, and thereby introducing excise duties of its own in a disguised form,[1] but otherwise the Provincial administration of forests is likely to be suitable and beneficial in every respect.

Court fees and fees charged for the registration of documents are closely connected with services, which are and and will remain Provincial; and such receipts should go to the Provinces, if they are to be regarded as payments made for services rendered and assessed on the cost of service principle. But the revenue derived from them leaves a surplus over and above the cost of administration; and, as it is not possible to graduate them according to the cost of service or the direct benefit derived, they are for all practical purposes taxes. The justification for their being administered by the Provinces lies in the fact of their being receipts incidental to the administration of law and justice. Whether the Provinces should have a free hand in dealing with them is another question. The Taxation Enquiry Committee were of opinion that in the matter of court fees uniformity of rates was desirable. There is a possibility of transfer of litigation from one Province to another owing to variations in the rates of fees, but it is very doubtful whether this has taken place to any appreciable extent. The experience of the

[1] At present, under various Forests Acts, some Provincial Governments are imposing export and import duties on forest products. Under the Burma Forests Act of 1902, forest royalties, which are practically export duties, are being levied on a number of forest products. These are actually collected by the customs officers, and their annual yield is Rs. 4 to 5 lacs. This practice is justified on the ground that it is not possible to collect forest royalties in any other way on account of the geographical features of the Province. Under the Indian Forests Acts, Provincial Governments can, with the previous sanction of the Government of India levy import duties on timbers entering their territories from outside British India, and some Provinces are getting a small revenue by imposing such duties. On principle, the imposition of these duties by the Provincial Government is essentially wrong; and, even when there are special circumstances justifying this practice, as in the case of Burma, it needs to be carefully watched lest it should be used for ends for which it is not intended.

Reforms period does not show that there is any need to impose restrictions on the freedom of the Provincial Governments in fixing the rates of court and registration fees. Probate duties, which are now collected as court fees, are the nucleus out of which a system of inheritance taxes has to grow in India, and their administration and assessment will have to be placed on a different basis; but, otherwise, there is everything to be said for provincializing these receipts.

Income-tax is a head which has been, and is likely to be, a bone of contention in the financial adjustment between the Central and Provincial Governments. There are arguments in favour of the division of its yield, but they do not weaken the case for the centralization of its administration. The reasons given by the authors of the Joint Report and the Report of the Meston Committee in support of their recommendation to assign income-tax to the Government of India are as valid as ever, and there are forces at work which render the necessity of its centralization more imperative with the advance of years. The chief reason why it is undesirable to provincialize income-tax is that it is not possible to provincialize income; in other words, as the base of the assessment of the tax is wide and transcends Provincial boundaries, it cannot be efficiently administered unless it is placed in the hands of a central authority with national jurisdiction. Provincial administration of the tax will be costly, and lead to evasion; and diversity in the rate and principles of assessment will give rise to the evils of multiple taxation, and involve serious inconvenience to the tax-payers. It is not necessary to elaborate the argument. 'If there is anything', to quote the words of Prof. Seligman, 'that may be considered as a well-settled induction from experience, it is that income-tax is less successful as the basis of the tax becomes narrower.'[1] The tendency, all the world over, to centralize the administration of this tax has already been described; and where this end cannot be achieved on account of constitutional difficulties or local

[1] *The Income-tax*, p. 645.

jealousies and prejudices, the situation leads to anomalies and abuses which involve inequity and friction in fiscal administration. A Provincial income-tax is unworkable because, when income is derived from an inter-Provincial business, or its sources are diverse in character and situated in different Provinces, it would, to adapt the words of the League of Nations' Committee on Double Taxation, be impossible in economic theory to get a direct assignment of a quantitative character of finally resultant income amongst all the Provincial agents who may be said to have had a finger in the pie. To put the same argument in simpler words, it may be said that it is impossible to secure an allocation of income among the different Provinces on a rational basis, if each one of them is to assess or collect its own income-tax according to the principle and rates determined by itself. In India local factors are still of some importance in economic life, but their importance is decreasing with every successive year; and, what is more, income-tax is imposed on classes of persons who, in most cases, do not owe economic allegiance to any one Province. The arguments in favour of the centralization of income-tax administration are conclusive and incontrovertible.

The same reasons can be urged against the adoption of a method which is sometimes advocated for giving the Provinces a share in the income-tax receipts, though their force is decreased by the fact that it provides for a basis of administrative centralization. It is said that income-tax may continue to be levied exclusively by the Government of India, but the Provinces may be allowed to levy what the French call *centimes additionels* or a surcharge, which will also be assessed and collected for the Provinces by the Central agency. This method is not used in any federal state for the benefit of the component states, but is employed in France, Belgium and various other European countries to supplement the income of the local authorities. It corresponds to our land revenue cess, which is levied all over India to raise revenue for the rural boards. A limit will have to be prescribed, up to which the Provinces may levy their surcharges; but even then there will be variations in rates within the limited

range, and it will not be possible to solve the problem of allocation of income without adopting some compromise or making arbitrary assignments.

The difficulty referred to above is, of course, increased manifold in the case of corporate undertakings with a wide basis of operation. In India, the super-tax on companies is a tax on corporations, with an arbitrary and illogical exemption limit. The Taxation Enquiry Committee has recommended that it should be converted into a true corporation tax. This has to be done as much in the interest of revenue as that of fiscal consistency. It is wrong in principle to treat individuals and corporations alike in the matter of taxation; for the latter have only a legal personality, and their existence and functions are determined by conditions of an entirely special character. The corporation tax is really a tax on franchise or privilege; and it should be assessed according to the principles applicable only to 'immortal' but fictitious persons, which are invested with individuality in order to secure the continuity of industrial undertakings and their management by competent men. Such corporations do business all over the country, and have branches and agencies in different cities and towns; their head-offices and factories are not necessarily situated at the same places, and their capital is either mainly raised in one Province and invested in another, or is raised from shareholders in all parts of the country and utilized for the development of industries in particular places. There are a large number of companies whose capital has been raised outside India, but which are doing business in many Provinces, though their Indian head-office is generally located at some important industrial centre. It is, in these circumstances, impossible for any one Province to tax the whole or a part of the income of firms with such wide ramifications. This point may be illustrated by an analysis of the figures of the companies' super-tax receipts for 1926–27.[1] In that year, out of about 5,900 companies, incorporated both in India or elsewhere, only 848 paid super-tax, i.e. had an income of

[1] *All-India Income-tax Return*, 1926–27.

Rs. 50,000 or more. The total yield of the tax was Rs. 2·56 crores; but out of this amount the share of the companies, whose income was Rs. 5 lacs or more, was Rs. 2·07 crores, and their number was 173. These companies had, in most cases, their head-offices in Calcutta, Bombay, Rangoon and Cawnpore; but they were carrying on their business in all Provinces, and their incomes assessed to super-tax may very well be said to have been earned in the country as a whole. The super-tax receipts were, to not a small extent, made up of contributions levied on banking, insurance, transport and trade corporations; and it is impossible to say how far a particular Province can be credited with the net earnings of such for the purpose of income-tax assessment. The problem of the allocation of income among the Provinces is insoluble in such cases. We have only to take the case of a railway company, which operates over different Provinces, or a mining or an insurance company, with their head-office at one place but selling branches and agencies over a large portion of India, to realize the futility of apportioning their net profits among the different Provinces. The economic facts have rendered a narrow basis of assessment in such cases extremely anomalous; and it is well to appreciate the importance of the factors which have produced this result. There are a number of federal States, in which corporation taxes are being assessed and collected by the constituent States; but the resulting chaos in their fiscal administration is a warning against the reproduction of similar conditions in other countries. We have still to introduce a comprehensive and well-developed corporation tax in India. It will probably be necessary to have, besides a general corporation tax, special taxes for corporate undertakings like public utility, banking and mining enterprises. The need of centralized administration of the corporation tax or taxes will, moreover, increase with the passage of time. The basis of taxation, in all these cases, is, in the words of Prof. Seligman, 'shot through with social considerations'; and this fact makes their centralization a social necessity.

Excise duties on liquors and drugs have been assigned to the Provinces in India, which is at variance with the

practice followed in all federal States. where excises of all sorts are reserved for the central authorities. A diversity of rates is generally regarded as a practice subversive of the principles of a federal union, and is, therefore, not permitted. In India, on the other hand, there is a great diversity of rates. They vary not only from Province to Province, but are by no means uniform within each Province; and, with the exception of Madras, the necessity of making them uniform is hardly appreciated in any Province. There is a prevailing belief among Provincial excise commissioners that these variations are inevitable, and that it is not possible to introduce uniformity. They attribute this diversity to differences in the conditions under which the excise administration has to be carried on and differences in the drinking propensities of the people. There are certain tracts of country, where excise control cannot be made as effective as in other parts, and people in some Provinces are much more sober than in others; but it is difficult to believe that this wide diversity of rates is really justified by differences in the conditions of administration and the habits of the people. It ought to be possible to reduce this diversity within very narrow limits, and to have uniform rates at least in the same Province. But the existing diversity is so great that it is impossible, for years to come, to have anything like a uniformity of rates in the country as a whole. The administration of restrictive excise duties has, therefore, for the present, to be entrusted to the Provincial authorities; but it will be necessary to make a concerted effort to reduce the variation in rates. Madras has practically established the same rate for country spirits all over the Province, and there is no reason why other Provinces should not be able to do as much. The incidence of excise duties is, in some Provinces, very low; and unless there are some compelling circumstances which make their enhancement difficult, they ought to be raised to a higher level. The whole question needs a sifting investigation; the Government of India has to give a lead in the matter, and urge upon the Provinces the desirability of co-operation for the introduction of a greater uniformity of rates.

Inter-provincial difficulties, due to the excisable articles produced in one Province being sold in another, have already been overcome by the general acceptance of the principle that duty should follow consumption. Something is to be said for the view that, if prohibition is to be introduced, it should be done on a national scale, the Central Government administering the excise duties and taking the necessary steps for the realization of the ideal; though the other view, that the experiment should first be tried in localities where the conditions are favourable, has also been long held, and found expression in the demand for local option. But it is not necessary to attach much weight to these considerations in the present discussion of the question of the allocation of sources of revenue. Prohibition will remain, for a long time to come, a distant ideal in India. The United States is spending nearly 30 million dollars for the enforcement of prohibition. In India, illicit distillation is much easier; and it will be necessary to have an even more effective preventive organization if the law is to be respected. India, to use the common phrase, cannot foot the bill of prohibition and has to be content with less drastic measures for combating the drink evil. This is the logic of facts, and has to be accepted, however disagreeable it may be in itself. Excise duties have, therefore, to be assigned to the Provinces.

These considerations apply to the duties on country spirits, toddy and drugs; but the consumption of country-made 'foreign liquors' and of imported liquors presents some special characteristics of its own, and their case has to be separately considered. At present, the imported articles are subject to a specific customs duty, which amounts to from 75 to 100 per cent *ad valorem*; and the Provinces are allowed to levy vend fees or transport fees, and thereby practically tap a central source of revenue. The country-made 'foreign liquors' are taxed by the Provinces at varying rates, which are in most cases lower than the customs duty. The situation thus created is obviously unsatisfactory, and involves possibilities of conflict between the Central and Provincial Governments. It is undesirable that the Provincial Governments should

levy an additional internal duty, or that they should have a motive for encouraging the sale of locally made liquors in order to realize a larger excise revenue for themselves. There is no reason why imported liquors and their Indian substitutes should not be taxed at the same rate. The local industry does not, as the Taxation Enquiry Committee has pointed out, need any protection; and the duty, which it has to pay, should be treated as a countervailing excise duty, and made equal to the import duty. This can be done either by raising the Provincial rates to the level of the customs duty or, at any rate, raising the excise duty to a point which may be considered suitable from the administrative and fiscal standpoints. But it does not follow that the yield of both customs and excise duties should be assigned to the same authority. This may be necessary as a measure of re-distribution of revenues; but it is not essential, as the Taxation Enquiry Committee thinks that it is, that both should be credited to the same head 'to put an end to the unhealthy competition that results from the division'.[1] Uniformity of rates with division of yield introduces, indeed, another complication, for the level of customs and excise duties will have to be decided upon by joint consultation, and it will not be possible to change it in the future without a previous common understanding on the point between the Central and Provincial authorities. But this complication is due to the anomaly of assigning customs to the Central Government and excises to the Provincial Governments, and has to be put up with on account of the peculiar circumstances in which we are placed.

The assignment of the yield of customs and excise duties on foreign liquors will also involve difficulties of re-adjustment on account of the varying consumption of imported liquors and differences in the amounts of revenue derived from excise duties by different Provinces. It will be impossible to ensure that gains or losses should be evenly distributed, or, at any rate, bear some relation to the financial position of each Province. It may be possible to get over some of these difficulties by making

[1] *The Taxation Enquiry Committee Report*, p. 174.

adjusting assignments from Central revenues, but even that will not meet the requirements of the case. The difficulties can be avoided altogether by not disturbing the existing arrangements, so far as the division of yield is concerned; and if uniformity of rates can be secured without any such changes, it is unnecessary to credit the receipts of these duties to the same head.

The Taxation Enquiry Committee has also recommended that the excise revenue from opium should be transferred to the Central Government. From the administrative standpoint, no convincing reason has been given by the Committee for introducing this change. The control of inter-provincial smuggling, a high uniform rate of duty, and the abolition of the system of the sales of shops by auction, are measures which can be adopted without the centralization of receipts. The international obligations, assumed by the Government of India, may make it necessary to exert simultaneous efforts in all Provinces to reduce the consumption of opium; but as this is not the only matter with regard to which it will be necessary to co-ordinate the activities of the different Provinces, that fact in itself does not necessitate the transfer ot receipts from 'excise' opium to the Government of India. It is doubtful whether the complete cessation of the internal consumption of opium can be regarded as an imminent possibility; and as the application of more rigorous restrictive methods will in any case require the co-operation of Provincial authorities, it is not necessary to make this change. The Government of India are of opinion that centralized administration of 'excise' opium presents difficulties of its own; and as the Provincial Governments are in a position to discharge efficiently the duties devolving upon them in respect of the control of opium consumption, the step recommended by the Taxation Enquiry Committee need not be taken. Such a change would create difficulties of re-adjustment, as the proportion which opium revenue bears to the total revenues varies from Province to Province, and its centralization would involve a dislocation of Provincial finances in different degrees. These difficulties ought, if possible, to be avoided; and as administratively it is

desirable that 'excise' opium should remain a Provincial subject, there is no necessity for introducing these complications.

General stamps are another head whose centralization has been recommended by the Taxation Enquiry Committee, on the plea that uniformity of rates is essential for commerce, and cannot be secured unless this head is transferred to the Central Government. The need of uniformity of rates is generally admitted; but it is not quite clear why it is impossible to achieve this end by retaining the Central control of certain items in the Stamps Schedule. They are already subject to Central legislation, and it would be possible to prevent variations in the rates of duty on documents of a commercial and quasi-commercial character if the Government of India continues to reserve to itself the right to fix the duties in such cases. There are two difficulties, which have to be provided against. One is that, if the Government of India decide to reduce the rates of certain duties in the interests of commerce, it will cause a loss of Provincial revenues. Such cases may arise, but will not involve serious inconvenience; and when the Provincial exchequers suffer any considerable loss on account of changes introduced by the Government of India, it should be possible to compensate them by making adjusting assignments from the Central revenues. The other difficulty is that a transaction relating to one Province may be carried out in another, and the former may suffer loss of revenue on that account. The Taxation Enquiry Committee has referred to the need of re-adjustment which has already arisen between the Governments of Bengal and Assam owing to transactions relating to Assam being executed in Bengal. The difficulty is merely technical; and it ought to be possible to pass on the credit for the stamp duty charged on transactions to the Provinces to which they relate. Stamps are an elastic source of revenue, and receipts therefrom increase with the growth of economic prosperity. In some Provinces they are more important than in others; and it is not desirable to centralize these receipts, unless circumstances arise which make it imperative to adopt such a

course. Such circumstances have not arisen up till now; and though the duties leviable upon certain important documents will remain subject to Central legislation, on the assumption that diversity in these cases cannot be permitted, it is not necessary to credit their receipts to the Central treasury.

This concludes the examination of all the major sources of revenue for the purpose of their allocation between the Central and Provincial Governments, from the administrative standpoint. The conclusion to which it leads us is that there is no need for re-allocation; and though in a few cases it would simplify matters if the receipts were centralized, the necessity of this does not exist, as the transfer of these receipts to the Government of India would involve the need of re-adjustments and cause great inconvenience. It is necessary to provide for a certain measure of co-ordination in such cases; but there are many other matters, with regard to which the Central Government will have to secure concerted action, and that in itself does not necessitate their transfer from the Provinces to the Government of India. In all matters, in which co-ordination is essential, machinery for the purpose has to be so designed as to enable the Province to have an effective share in the evolution of common policies, and to minimize the possibility of arbitrary control by the Government of India as the supreme executive authority of the country. This aspect of the matter will have to be further considered in Chapters VII, VIII and X; and nothing more need be said about it here. There is, to state this once more, no need of the re-allocation of existing resources on administrative grounds. But this does not solve the problem of the re-adjustment of fiscal relations between the Government of India and the Provinces. If revenue is to follow control, it leaves matters as they are, and cannot, therefore, be accepted as a satisfactory arrangement in view of the admitted need of giving to the Provinces much larger fiscal resources. In fact, the heart of the problem has still to be considered, and the discussion of its administrative aspect only clears some preliminary difficulties out of the way. But before we take up the question of specific re-adjustments, and discuss

the ways and means of enlarging the revenue of all the Provinces taken together, and of certain Provinces whose resources are more limited than those of others, it is necessary to consider the ways in which the total public revenue of the country can be increased; for, as already stated, it is our national duty to explore all avenues of additional taxation and increase the income of all public authorities in India to the largest possible extent. This will really be true economy. The standard of public expenditure, generally, in India is low, though in particular directions it has risen to heights at which it cannot possibly be maintained. We shall have to spend more and not less in the years to come for the satisfaction of our common needs, for, as Viscount Milner has put it: 'Mere reduction of expenditure is not necessarily economy. It may be, it often is, the most pernicious form of waste.' [1] In India it will be 'the most pernicious form of waste' to check the growth of expenditure on the crying needs of our national life. We must prevent what is unmistakably waste in our existing public expenditure, and pursue economy by what Viscount Milner calls 'steady, continuous, minute control of details'; but the necessity of a large and rapid expansion of expenditure on vital public services is writ large on every detail of our national life, and cannot be avoided. We need all the money that we can raise by additional taxation to make this increase of expenditure possible; and it is, therefore, necessary to discuss how the expansion of public revenues can be brought about by imposing new taxes and enhancing the rates of old ones. The question of the allocation of the new taxes will, of course, have to be considered along with the general discussion of their place in our national fiscal system.

There are three new taxes whose potential importance as revenue producers has already received considerable attention. These may be taken up first; and the inheritance tax is one with regard to which, on theoretical grounds, there cannot be much difference of opinion. The other two are a tobacco excise duty and an income-tax

[1] Viscount Milner, *Questions of the Hour*, p. 131.

on agricultural incomes. The inheritance tax as is well known, is imposed in almost all the important countries of the world. In 1885 it was 'a fiscal curiosity', but now it is an important constituent of nearly all fiscal systems; and its further development as perhaps one of the most powerful engines of social reconstruction, is only a question of time and that not a long time. India is the only country of importance, which has not made use of this fiscal expedient in a well-developed form; and now that there is a need for the widest possible expansion of public income, it is only natural that we should look upon the imposition and development of death duties as the method which has the first claim on our attention. The Taxation Enquiry Committee have examined the question at length, and have expressed their opinion that the introduction of this tax is necessary in the interests alike of fiscal equity and necessity. But their recommendations are open to criticism on the ground of their halting character. The intricacies of the laws of inheritance in India make it necessary to proceed with a certain amount of caution, but do not justify compromises which may involve the differential treatment of particular communities, or are based on the assumption that the inheritance tax is a levy on transfers and not on legacies. The social purpose of the tax cannot be fulfilled unless its amount bears some relation to the ability to pay of the beneficiaries or reduces the inequalities in income. The Committee on National Debt and Taxation in Great Britain, commonly known as the Colwyn Committee, have defended the estate duty against the charge that it takes no account of differences in the ability to bear the burden, and say: 'There is some justification for looking on wealth acquired by inheritance in the nature of a windfall, the taxation of which does not call for the same nice adjustment as the taxation of income towards the existence of which a man has himself contributed.'[1] The argument is specious but not convincing; for 'the trend of modern thought', in the words of the Australian Commission on Taxation, 'is in the direction of taxing a

[1] *The Colwyn Committee Report*, p. 182.

person in respect of his interest in something of value rather than taxing the thing of value, irrespective of its ownership or the distinction of any beneficial interests derivable from it.'[1] An inheritance tax should not be imposed in India merely as a tax on estates in transit, but should make due allowance for personal factors in its incidence and effects. It may be that, in certain cases, there is no succession or acquisition, but only devolution by survivorship; but, in fact, the social effects of the institution of inheritance are the same in both cases, and it is of greater importance, in the imposition of death duties, to pay heed to the practical working of the tax than to 'the medley of laws and customs of inheritance'. The law of personal inheritance has nothing to do with the payment of the tax; and the legal aspect of the matter only needs to be examined with a view to prevent the tax-payers from defeating the purpose of the tax by recourse to the innumerable niceties of the law. An inheritance tax would have been introduced in India long ago but for the undue importance attached to legal intricacies; and we must no longer allow these to obstruct a measure of great social and fiscal importance. Inequalities in the distribution of wealth are even more glaring in India than in other countries; and the incidence of taxation on the poorest classes in even more disproportionate to their economic capacity. An inheritance tax has to square with the facts of our economic life and our fiscal system; and the measure should be conceived and executed in a such way as to function both as an important compensating factor and as a productive fiscal expedient. The Taxation Enquiry Committee have recommended a scale of inheritance duties ranging from ½ per cent on amounts falling between Rs. 5,000 and Rs. 10,000 to 6 per cent on amounts in excess of Rs. 20 lacs. We cannot impose very high duties in India at the outset; but the scale proposed by the Committee is definitely too low, and on amounts exceeding a lac the tax should be steeply graduated. It ought not to be impossible to administer the tax successfully if legacies

[1] *Report of the Australian Commission*, Fifth Report, p. 232.

exceeding 5 lacs are taxed at the rate of 20 or 25 per cent. even in the beginning. The question requires exhaustive examination and also a great deal of courage, on the part of the progressive parties in India, if it is to be made a living issue in our national politics; but it is high time to realize that we cannot do without an inheritance tax any longer. It is not possible to form an estimate of its prospective yield, but it ought to be considerable; and in Provinces like Bengal, Bihar and Orissa, the United Provinces and Bombay, where inequality in the distribution of wealth is very striking, the contribution made should go a long way in increasing their fiscal resources. In Bengal, even the present probate duty on a rich estate brought in 1929 a windfall of Rs. 52 lacs. In Bihar, there are estates one of which will, if subjected to an inheritance tax of even 10 per cent, yield a revenue whose amount will mean very great relief for its straitened finances. The rates of the duty and the revenue from it will be determined by the interplay of factors, with regard to which it is impossible to make a definite forecast. There is general agreement among the students of Indian taxation that this tax ought to be introduced; and if we are to be a truly democratic nation, one can very well expect that it will in due course occupy a very important place in our fiscal system.

As regards the administrative aspect of the measure, it is unnecessary to say much. The Taxation Enquiry Committee have pointed out the necessity of Central legislation, owing to the undesirability of making changes affecting the personal law of communities which might operate differently for the same community in different parts of India. It is also highly desirable that the administration of the tax should be centralized. The administration of inheritance and income-taxes by the same authority leads to an efficient assessment and collection of both; and the conflict of situs and domicile is likely to occur as frequently in the case of the inheritance tax as in that of the income-tax. Inheritance taxes are being levied and administered by the State authorities in several federal states; but this has led, as already

stated, to conflict of jurisdictions. In the United States, as stated in the note by the legal adviser to the Taxation Enquiry Committee on death duties,[1] it has been pointed out that it is theoretically possible for a particular item of property to be taxed cumulatively by different States to a sum amounting to 130 per cent of its value. Centralized administration of the inheritance tax, therefore, is a necessity if similar confusion is to be avoided in India. It is, however, not necessary that the receipts of the tax should be appropriated by the Government of India. They can, if necessary, be assigned to the Provinces; and difficulties of apportionment, owing to the situs of the property and the domicile of its owner being in different Provinces, can be overcome by accepting the convention that the tax on real property should go to the Province of location, and that on personal property follow the residence of its owner. Since, however, the tax will have to be graduated according to the total value of the property, this convention will mean that the tax will be apportioned between the Provinces of location and residence in the proportion which realty and personalty bear to the total value of the estate. Division of the yield is also adopted when multiple taxation of the same estate by different authorities is to be avoided. In the United States and Canada, the States and Provinces which are trying to promote a comity of fiscal inter-relations, have adopted the method of reciprocal exemption of personalty; and the draft convention[2] prepared by the Economic Committee of the League of Nations, which is to serve as a basis of bilateral international negotiations, makes what is practically a similar provision for avoiding double taxation as regards death duties. In India, double taxation will not arise if the administration of the inheritance tax is centralized; and it will be possible to divide its yield on the basis referred to above. This arrangement will satisfy the needs of efficiency, harmony and equity.

[1] *The Taxation Enquiry Committee Report*, vol. II, p. 251.

[2] *Monthly Summary of the League of Nations*, vol. VIII, No. 10, November 1928.

It is generally admitted that a tax on tobacco is a desirable source of revenue on account of the inelasticity of our resources. Proposals for the imposition of such a tax have been made whenever the Government of India found themselves in need of funds, but were dropped on account of the administrative difficulties. Now the situation, as the Taxation Enquiry Committee have shown, has considerably changed. With the import duty at about 100 per cent, a large tobacco manufacturing industry has grown up, and is producing millions of cigarettes. As many as seventy-two Indian States are successfully levying tobacco duties, and deriving a large revenue from this source. On economic grounds, the argument in favour of an excise duty on tobacco is, of course, that, being a tax on a conventional necessity, its incidence will rest on what Sir Josiah Stamp would call a non-functional surplus. It is not possible to say, with any amount of precision, what the yield of the tax will be; but it will be large. According to the *Review of the Trade of India*, 1927–28, the total consumption of cigarettes in India in that year was about 16 million pounds, out of which 10 million pounds[1] were made in India. The total customs revenue from tobacco in that year amounted to Rs. 2·17 crores. The rates of duties on cigarettes were Rs. 7 and Rs. 10-8 per thousand; and as cigarettes are the most important item of tobacco imports, the bulk of the revenue was derived from duties on cigarettes. Excise duties on Indian-made cigarettes, if they are to be specific duties, cannot be as high as the import duties since they are cigarettes of a cheaper variety; but assuming they are 75 to 100 per cent *ad valorem*, and there is no reason why they should be lower, their yield should not fall short of Rs. 1·5 crores. Cheap cigarettes have in *bidis* a very important rival; and if they are to be taxed, the latter will have to be subjected to an equivalent duty. As regards the locally produced tobacco, though the area under cultivation exceeds one million

[1] It is estimated that Indian-made cigarettes weigh about 2½ lbs. per thousand. At this rate, the total production in India in 1927–28 was about 4,000 millions.

acres, and its production is very large,[1] the difficulty in the way of imposing an excise duty, as has been pointed out by the Taxation Enquiry Committee, is that tobacco does not pass through any well-recognized stage of production at which an excise duty can be levied. The only method, which is likely to succeed, is the one which has been suggested by the Committee, i.e. to begin by a system of fixed fee licenses, gradually bring the trade under control, and then develop a system of monopoly of vend and the sale of that monopoly by auction. It will take some time to bring this system into full operation ; but once it has been developed, it ought to yield a revenue, whose amount cannot be estimated just at present, but ought to be considerable. In England the incidence of the tobacco duty is about £1-4*s*. per head ; but even if we aim at an average incidence of only four annas per head in India, the yield of the duty should exceed Rs. 6 crores. The fragrant weed is indulged in so widely in India that a system of excise duties, once it has been brought into working order, should be a productive source of revenue here as it has been in other countries of the world. The imposition of the duty will have a certain restrictive effect on consumption, but that would not be unfortunate. The incidence of the duty will fall mainly on the poorer classes ; but, as already remarked, in India we have to look more to a change in the incidence of the benefits of expenditure than to changes in the incidence of taxation for mitigating the regressive character of the latter. Here it is quite impossible to make the incidence of taxation as a whole proportional, not to speak of making it progressive. We have to develop our revenues all the same ; and this necessity imposes upon us the corresponding obligation to keep a close watch on all expenditure which is not primarily of interest and importance from the standpoint of the well-being of the

[1] According to the estimate given in *Taxation Committee Report*, vol. II, the gross annual production of British India is about a thousand million pounds, and its value about Rs. 20 crores.

masses. This tobacco excise duty has, then, to be fully developed.

An excise duty on the manufacturing industry will, of course, have to be assessed and collected by the Central authorities. Development of the duty on vend will depend upon the extent to which the trade can be brought under control; and it will not be possible, for some time, to ensure the same degree of effective control in all areas. Experiments will have to be made in selected tracts, and then the results applied over wider areas. This means that, in the initial stages, the Provincial authorities will have to administer the duties on unmanufactured tobacco. It will be necessary to prevent all avoidable variations in the rates, and to maintain uniformity in the methods of assessment of the duties as far as possible. Diversity in the rates of excise duties is to be deprecated in all cases; and it should be kept within well-defined limits, and permitted only in the early stages of the development of the system of excise duties on tobacco. Later on, probably, it will be necessary for the Government of India to administer these duties themselves, as also perhaps the excise duties on liquors and drugs.

The exemption of agricultural incomes from the operation of the Income Tax Act is a feature of our tax-system, which has, of late, attracted considerable attention; and it is generally held that the concession granted to the agricultural classes is not justified by the circumstances of the case, and ought to be abrogated. This change is advocated by those who strongly maintain that land revenue should be regarded as a tax and not a rent. Land revenue is, from this point of view, an agricultural counterpart of income-tax. It is true that there is no exemption limit, no abatements or allowances for wife and children, and no graduation in the assessment of this tax. But, in theory, it is a tax on net profits or rent; and the rates of the tax in spite of the wide range of their variations, are relatively high even in those areas in which re-assessment has not taken place for about 150 years. It has been estimated that the average incidence of land revenue in Bengal and Bihar is about

12½ per cent of the net profits, though it varies very widely from district to district. In the temporarily settled areas, the incidence of land revenue is, of course, much higher, and varies from 25 per cent to 50 per cent or even more. It is a flat rate, but quite a high one; and as most of the owners of land are poor and those, who are well-off, can be regarded in most cases only as moderately rich, its incidence is heavy, and it is by no means fair to say that their exemption from income-tax is an unwarranted concession and ought to be repealed. Under the Income Tax Act, when the total income is Rs. 40,000 or upwards, the rate of income-tax is one anna and six pies in the rupee, which gives a percentage rate of about 9·4; and though incomes above Rs. 50,000 are subject to super-tax, the effective rate per rupee does not become 25 per cent till the total income exceeds Rs. 4·5 lacs. The number of landlords, whose incomes exceed Rs. 4·5, lacs, is exceedingly small; but if land revenue is to be regarded as a tax, then comparing class with class, the fiscal burden of even the richest professional or business man is less heavy than that of the landlords with the same incomes. The incomes of the vast majority of the land revenue payers are below Rs. 40,000; and, as they are, in almost all cases, paying more than 9·4 per cent, persons liable to income-tax cannot have a grievance that the tax-laws of the country discriminate against them. It is really the agricultural classes who have, if a comparative view is taken, a legitimate grievance in the matter.

It is, therefore, not possible to advocate the repeal of exemption granted to agricultural incomes, in the interests of fiscal equity, unless we shift the ground on which we support the additional taxation of landed interests. It has now been fully established that the recipients of agricultural incomes have no prescriptive rights in the matter. They have been liable to income-tax before; and its re-imposition upon them will not involve any breach of promise, express or tacit. That clears a preliminary difficulty out of the way; but the question has still to be argued on its own merits, and with special reference to the case for the levy of

additional taxation on agricultural incomes. It is not difficult to find reasons which are both adequate and valid, if we emphasize the social as distinguished from the fiscal aspect of the question. Our system of land-taxation is purely impersonal, i.e. it has no relation to the economic capacity or ability to pay of the tax-payers, and treats the rich and the poor alike. That is against all accepted tenets of taxation, and is a defect which should have been remedied long ago. But since nothing has been done to introduce a personal element into the assessment of the land-tax all these years, it is all the more necessary that something should be done in the immediate future to realize this highly desirable object. In theory, the first step in this direction should be the exemption of the small land-holders from the payment of this onerous tax. That would be an act of elementary justice; but the amount of revenue which will have to be sacrificed, if this reform is introduced, is so enormous as to make this quite impracticable. But it should not be impossible to graduate the tax, and thus make its incidence heavier on the more prosperous members of the agricultural community. The value of land has risen very rapidly in the last six or seven decades in all Provinces; and the rise is almost entirely due to social causes. There is much greater pressure of population on land, and, therefore, competition for its acquisition is intense and acute; prices have risen on account of the increasing demand for agricultural products, the working of our currency system and world factors; the general progress of the country and the development of communications have reacted on land values, and increased them immensely; and in a large number of cases the provision and extension of irrigation facilities, at the expense of the State, have also contributed largely to the same result. The increase in land values and land incomes varies very widely in different parts of the country owing to the varying importance of these factors, and owing, above all, to the varying incidence of land revenue from district to district and even, in some cases, among the sub-divisions of the same district. There is a large element of unearned surplus

in the capital value of land and, of course, in the income which it yields. To these considerations is to be added another, which is generally present in the minds of those who are in favour of the imposition of the income-tax on agricultural incomes, though it is not explicitly stated. Landlords, big and small, do not deserve well of the nation. In Provinces in which they are predominant, their influence on the economic and social life of the people is of an unwholesome character; they resort to high-handed and oppressive practices for the realization of their legal and illegal dues; and being so generally absentees, they do nothing for the agricultural improvement of the country. It is because the landlords are the special beneficiaries of social progress, and are also otherwise rendering no useful service to the community that it is desirable to impose heavier fiscal burdens upon them. In other words, we have to introduce in the system of land taxation in India the principle of differentiation. Landlords are not the only persons who are not doing their bit in return for all that they are getting from society; but they are the most conspicuous members of the class to which they belong, and the reasons for which they have received the special attention of social and fiscal reformers in all countries also make it necessary in India to take action and limit their sphere of influence. Landlordism is, as a matter of fact, an exotic institution in India; and the vested interests, which it represents, are of comparatively recent growth. It is not possible to abolish it all at once; but it is desirable to levy a differential tax on those who are occupying a privileged position on account of the introduction of this institution.

It is, as a measure of differentiation, that additional taxation on landed magnates and even smaller proprietors justified. It is not possible to change the frame-work of the land-revenue system. It is rigid, and is growing more and more so every year. The imposition of a differential tax within the four corners of the land-revenue settlements is, therefore, out of the question. This object can be realized by repealing Item viii of Clause 3 of Section 4 of the Indian Income Tax Act of 1922,

and making agricultural incomes liable to income-tax like other incomes, allowing, of course, for the deduction of the amount paid as land revenue. This may probably be the form in which it will prove expedient to introduce differentiation; but is a very rough and ready method of achieving this purpose. There is no relation between the scale of graduation of the income-tax and the progression, which it may be necessary to introduce, if it is to be really a measure of differentiation. The scale which will do for the one purpose cannot possibly also fulfil the other. The principle of differentiation requires that the scale of progression should be determined by the extent to which social factors determine the amount of an income or the capital value of the source from which it is derived, or by the relative weight of unearned increment in the income of an individual or in the capital value of the property owned by him. It has already been remarked that the extent to which accretion to land values has taken place, owing to the working of social factors, varies in different parts of the country. In Bengal and Bihar much of the unearned increment is due to the low incidence of land revenue and to pressure of population, in the Punjab to the construction of canals and the development of new markets, in Oudh to the liberal provisions of tenancy legislation and to some other features of land-tenures, in Sindh to the prospective benefits of the Sukkur Barrage Scheme, and in all other Provinces there are special causes at work which make it impossible to devise an all-India measure for taxing the differential element in land values. The limit of exemption, the scale of graduation and other provisions of the tax-law must be adjusted to the special circumstances of particular Provinces. Mere repeal of the exemption of agricultural incomes from income-tax will be a very inadequate method of differentiation. This end can be attained much more effectively by introducing a graduated tax on the capital value of land. In theory, a tax on income or on capital value, as the source of income, can both be made to serve the same purpose, for the latter is a function of the former; but in India, as income-tax cannot be at once an ordinary progressive tax and a differential

tax on land, we shall have to make use of a special fiscal expedient for the latter purpose. A tax on the capital value of land will be eminently suitable as a measure for appropriating a part of the social income which is in the hands of those who have done least for its production. A tax on capital value will be easily and efficiently administered. Its cost of collection will be low, as in most Provinces the revenue department can also undertake to assess and collect it. Capital value being an objective fact, it will not be necessary to employ hypothetical data for its assessment. It will be possible to know the market value without much difficulty. And its chief merit will be that it will be possible to develop it as a real differential tax. The measure can be framed in the light of local circumstances, and due weight can be assigned to those factors which are of special importance in particular areas. This tax, if properly developed, contains within itself the potency and promise of becoming a real balancing factor in our tax-system It will introduce a personal element into our land taxation ; redress the inequalities due to the varying incidence of land revenue ; enable Provinces like the Punjab, the United Provinces and Sindh to get at the fortuitous accretion of wealth due to State irrigation for fiscal purposes ; and make it possible for Bengal and Bihar to urge their claim for some special consideration in the new financial settlement, to which they are otherwise undoubtedly entitled, with an assurance which, in the absence of this obvious means of self-help, they would otherwise be unable to command. There is one cardinal objection against such a tax, and that is, that it is new. There will be a tremendous outcry against it. The favourite method of damning a new taxation proposal by strong words, which has been used in all lands and at all times, will be brought into full operation. We shall hear a great deal about broken promises and natural rights. The difficulty is formidable, but has to be faced. Opposition will also arise if it is proposed to make agricultural incomes liable to income-tax, though it may not be quite as vehement in that case. Now the only justification for an income-tax on agricultural incomes

is that it will differentiate against certain classes, who are rightly liable to discriminatory taxation. The advantages of imposing a tax on capital value instead are so many and so considerable that it is fully worth while to raise the issue in a form in which it bears its true character on its face. There was never a new tax which was introduced without opposition ; only in some cases it was more determined than in others. Vested interests may be depended upon to give battle royal to all who have an eye on what they have been accustomed to call their own. They will put up a stiff fight. But when justice, necessity, convenience and even expediency are in favour of a particular fiscal measure, first, it is necessary to educate the public opinion in its merits, and then to carry it through with the conviction that all new taxes are unpopular in the beginning but that time wears off the edge of opposition in the end.

The administration of the tax on the capital value of land will, of course, be in the hands of the Provincial authorities. Each Province will have its own exemption limit, scale of graduation and administrative machinery. The revenue officers, as already remarked, will probably be able to discharge all administrative duties in connexion with the new tax in most Provinces. Its yield cannot be estimated. It has been estimated that the yield of income-tax on agricultural incomes will be about Rs. 70 lacs in Bihar, and it is expected that about the same amount can be realized in Bombay. The capital value duty should contribute at least that much in the beginning, and later on it should be possible to increase the revenue derived from this source. It may not perhaps be very much beside the mark to say that for the whole country a revenue of about Rs. 5 crores may be expected from this levy. But this is a matter, with regard to which each Province will decide for itself as to whether it would like to introduce this tax ; and if so, how much it would raise from it. Provinces, whose resources are limited and inelastic, will have to show that they have fully developed this tax and all other taxes, if they are to receive special consideration in the financial settlement of the future.

These three taxes are the most important taxes which can be levied to increase the public revenue. The turnover tax, which is being levied in a number of countries, will probably have to be left for the use of local authorities. There are other excise duties which can be introduced, but it is not possible to discuss them here. The development of these taxes will, in any case, take time. It is necessary to elaborate such proposals in detail, study local circumstances, provide suitable machinery and make other arrangements for their administration. In the case of the inheritance tax, tobacco excise duty and capital value duty, the creation of administrative machinery should not involve much trouble or delay as they can be assessed and collected by the income-tax, excise and revenue departments, respectively ; still a new tax has always to pass through a period of experimentation, and cannot give its full yield for a few years after its introduction. As it is a matter of great importance to provide for the immediate expansion of revenue, the question of the enhancement of existing taxes, and even of the re-imposition of those which have recently been remitted, has next to be considered. As few of the Provincial taxes can be expected to be of much use in this respect, consideration must be confined to the central taxes.

Of these, customs are the most important. They yield about Rs. 50 crores. The rates of the duties are high for a revenue tariff, and only in few cases it is possible to raise them higher. The need of a thorough scrutiny of tariff schedules and its further elaboration is admitted. It is necessary to examine the duties and increase the number of specific items, and though in some cases it may be necessary to reduce them on account of the point of diminishing returns having been reached, there are also cases in which the dutiable article can stand higher duties. In the case of tobacco, for example, it may perhaps be necessary to raise the duties still further and to raise from them another Rs. 50 lacs in order to facilitate the imposition of excise duties. The duty on motor cars should again be raised from 20 to 30 per cent; this will bring an additional revenue

of about Rs. 40 lacs. The tax on liquor also, as the Taxation Enquiry Committee has pointed out, would bear an increase, though it will be necessary to take into account the rates on Indian-made liquors and fix a rate which can be borne both by Indian-made and imported liquors. There is no reason why gold and silver bullion and sheets should be allowed to be imported free of duty,[1] and an *ad valorem* duty of even 5 per cent in the case of gold, and 3 per cent. in that of silver,

[1] Prior to 1910 silver bullion and coin, other than current coin of the Government of India, were included in the general tariff schedule of articles liable to an import duty of 5 per cent *ad valorem*. In that year it was necessary to raise additional taxation, and it was decided that silver was a luxury article on which an additional import duty might suitably be imposed. The rate was accordingly raised to 4 as. per ounce. The yield of this silver duty was about one crore annually before the war. During the war, on account of the prohibition of the import of silver, there was no yield ; and the silver duty was abolished after the war in pursuance of the recommendations of the Babington Smith Committee. Seeing that the bullion value of the silver rupee is much lower than its monetary value, the duty on silver can have no effect on our currency system. A three per cent duty is, as a matter of fact, very low, and it ought soon to be raised to the pre-war rate. Now that it is proposed to 'dethrone' the rupee, the currency aspect of the duty will decrease in importance with every step that is taken towards the ultimate deposition of silver.

The duty on gold, however, is on a different footing ; and it is, in theory, not desirable to create obstacles in the way of the free inflow and outflow of a commodity which is to be the basis of our monetary system, and through which the balance of our international account will be adjusted. But India is the proverbial sink of the precious metals, and her import of gold for non-monetary purposes is far in excess of her monetary requirements. The imposition of a small duty will, besides yielding revenue, have a slight deterrent effect on the gold-using propensities of the people. The official selling price of gold for delivery in Bombay will have to be raised so as to include the amount of the duty, i.e. it will be Rs. 21-3-10, plus twice the cost of transport, plus a 5 per cent duty. The selling price of gold for delivery in London will, of course, not be changed on account of the imposition of the duty. The duty ought to be much higher ; but the currency complications render it impossible to realize its full fiscal possibilities. Under Indian conditions, high import duties on gold and silver are an extremely suitable method of increasing the public revenues.

may be expected to yield a revenue of about Rs. 1·40 crores.[1]

These are all luxury taxes, and can, therefore, be imposed without causing any hardship. Careful enquiry will suggest other articles which can also be taxed at a higher rate.

In the arithmetic of customs, two and two do not always make four ; and it is necessary to gauge the degree to which the demand for a commodity is elastic, before levying a higher import duty on it. It ought however to be possible to increase the revenue from import duties by about Rs. 3 crores by making well considered changes in the rates.

The normal growth of trade, and higher rates in a few cases, will make it possible for the Government of India to add to their resources. The administration of tariff duties can, it is admitted, be made more efficient ; and any necessary additional expenditure will be a good investment from the revenue standpoint.

As regards export duties, it may be admitted that they ought to be used sparingly, and the conditions laid down by the Fiscal Commission ought to be adhered to. But even so there is no reason why the revenue derived from export duties should not be considerably increased. The export duty on tea was abolished in 1927–28. The Taxation Enquiry Committee recommended that the duty should be continued, unless the condition of trade indicated that it was having a prejudicial effect. They referred to the increase since 1913–14 in India's share of the world trade from 39 to 49 per cent., and did not see any necessity for the repeal of the duty. India has more than maintained her position in world markets since the Committee submitted their report, and the prospects of the tea industry are in every way satisfactory. In 1927–28 the duty was abolished, merely because the Government of India found that they could levy higher taxation on tea companies in another way. Till then they had been assessed to income-tax on 25 per

[1] Imports of gold in 1927–28 on private account were valued at 18·14 crores, and those of silver at 16·44 crores.

cent of their total profits, the balance being regarded as agricultural profits and, therefore, not liable to income-tax. It was pointed out that this proportion was unduly low, and that the non-agricultural profits of the tea companies amounted to at least 50 per cent of their total profits. This change made it possible for the Government of India to get an additional 45 lacs. The under-assessment of tea-companies was till 1927–28 a serious defect of the Indian Income-Tax Law, and its partial removal in that year was only a measure of reform, the adoption of which had been overdue for a very long time. The position of the tea companies ought to be further examined, and any possibility of under-assessment fully provided against. But that has nothing to do with the question of levying an export duty on tea. India is holding her own in world markets, and the resumption by Great Britain of trade relations with Russia, which took about 7 million pounds of Indian tea before the war, will make it possible for the industry to regain a lost market. Moreover, her principal competitor levies an export duty, which is double the rate of the repealed Indian duty. There is no reason why the export duty on tea should not be revived, and its rate made equal to the rate levied in Ceylon. The old duty was yielding about Rs. 50 lacs. Since then trade has expanded, and it should be possible to get one crore by the imposition of the duty; and we may expect the amount to grow in future years. It is also necessary to impose an excise duty on tea consumed within the country. India imports about 8,000,000 lbs. of tea from foreign countries, and consumes about 13,000,000 lbs. of indigenous tea. The imported commodity has to pay an *ad valorem* duty of 15 per cent; and it is proper that a countervailing duty should be imposed on Indian tea. This duty should yield about Rs. 40 lacs a year, if not more. The re-imposition of the export duty and the introduction of an excise duty will bring to the public exchequer nearly Rs. 1·5 crores, a year or two after the levy of these duties. This is a substantial amount; and India can ill afford to do without it.

The use of export duties for protective purposes is undesirable, but the imposition of light revenue duties on

the exports of oilseeds need not be deprecated. Oilseeds occupy the fifth place among our exports. In 1927–28 the exports of oilseeds were valued at Rs. 26·69 crores. India supplies a very large proportion of the world demand. In the linseed, rapeseed and sesamum trade, India's percentage is very high. A duty of 5 per cent on our exports will easily yield over a crore, and need not weigh heavily on the trade. It may also be possible to levy a light duty of Re. 1 per bale on the exports of raw cotton, and thereby realize about Rs. 40 lacs; but it will be advisable to wait for a few years till the conditions of trade are more stable than they have been for some time past. The Taxation Enquiry Committee were of opinion that lac was a suitable article upon which an export duty could be levied. The invention of a synthetic substitute is a possibility which has been in the air for some years, but the risk of its consummation will not be increased by the imposition of a light export duty. The value of our exports in 1927–28 amounted to about Rs. 7 crores, and a duty of Rs. 5 per maund will add about Rs. 30 to 35 lacs to our resources.[1] India has practically a monopoly of lac. It is an industry which is capable of very great development, for the methods of production and manufacture are in most cases very crude. A small export duty will do the industry no harm.

There are three duties, two of them excise, and one of them customs and excise, whose case may also be briefly considered from the standpoint of revenue expansion. Of these, the excise duty on kerosene oil can be disposed of easily. At present, imported kerosene pays a duty of 2½ as. per gallon, while kerosene produced in India is subject to an excise duty of one anna per gallon. In 1927–28 India imported 94½ million gallons, and as the total quantity of kerosene available for consumption has been estimated at 229 million gallons; it means that the quantity produced in India amounted to 134½ million gallons. The excise

[1] The price of shellac fluctuates within wide limits, but an average of Rs. 95 per maund can be assumed for calculating the likely yield of the export duty.

duty yielded Rs. 97·42 lacs in that year. Now the Tariff Board has enquired into the conditions of the industry, and is of opinion that it is not entitled to the grant of protection. The Government of India have accepted this conclusion, and it may be assumed that the industry can stand on its own legs and need not be subsidised. The price of kerosene is determined by world parity, and the fact that the excise duty is lower than the import duty means that the oil industry is receiving a subsidy of about a crore, to which it has no claim; and the interest of the tax-payer requires that the excise duty should be raised to the level of the import duty. The price of the kerosene produced in India is slightly lower than that of the imported article; and an equal specific duty would press more heavily upon it. It may, therefore, be right to make the excise duty a little lower than the import duty; and probably a duty of 2 as. per gallon will do to neutralize the differential advantage which the industry is now enjoying on account of the disparity of the two rates. It is necessary to make this change in the interests both of fiscal rectitude and addition to the public revenues. The enhancement of the excise duty to 2 as. may be expected to yield about a crore.

The other two duties which we have in mind have been the subject of bitter controversy in the past, and it is almost impossible to secure a dispassionate consideration of their place in our fiscal system. They have both been political issues, and any reference to them will at once revive the battle-cries which were raised against them in the past, the echoes of which are still ringing in the air. The salt-tax is to the Indian voter what a tax on bread has been to the British voter even since the repeal of the corn-law duties. It is generally assumed that the reduction of the duty, if not its complete repeal, should be the first charge on any surplus that may accrue in the near future; and any proposal for its enhancement must, of course, be keenly resented and resisted with the organized strength of the whole nation as an outrage upon its dearly cherished sentiments. But, in spite of the situation being what it is, it is here proposed that the salt-tax should be doubled, in

order that the additional revenue thereby derived may be available in making the necessary financial re-adjustments. The salt-tax is a tax on the poor man, and also on a necessity of life. Belief in its iniquity is an article of faith with us, and its enhancement may be said not to be practical politics. All this is true; but the argument of this chapter is based on the assumption that things are going to be very different in the near future. The foundations of our present political and non-political system will have to be examined; and once the need for their revision becomes patent, the fact will have to be cheerfully accepted. It is an obvious and imperative necessity to lay our hands on all the money that we can get for our national development. We are moving too slowly, and have to make a determined effort to forge ahead. This fact has been referred to so often that it is not necessary to reiterate it. All other classes must be taxed and taxed much more heavily; but in India, where the poor are in such a vast majority, it is impossible to raise additional revenue which will be adequate for the purpose in view, without taxing them in one form or another. The nation cannot pull its full weight without putting additional taxation on the great bulk of its people. It is much better that the poor man should pay about as. 12 a year on his family consumption of salt, and provide Rs. 6 crores for public expenditure on education, health, agricultural improvement and other vital needs of his life than rot in his pathetic contentment with things as they are. The Reforms have made very little impression on his inertia, ignorance and outlook. He has to be aroused from passivity, and made to take his proper place in the march of progress. It must, of course, first be made sure that the money, which will be taken from him, will be returned to him in a form which will be much more beneficial for him. In one of the ancient books of the Hindus the king has been counselled to take money from the people as the sun takes water from the earth little by little, but only to return it in the form of fertilizing showers. We have no right to take a pice more from the poor man unless we realize the moral obligation of giving it back to him in a manner which

can be compared to a 'fertilizing shower'. As it is, he is not getting an adequate return for the fiscal burdens which he has to carry. Taking it for granted, then, that the revenue raised from the doubling of the salt-duty will be spent for the benefit of the masses, it ought to be possible to obtain support for the view that the duty should be raised to Rs. 2-8-0 per maund. This will yield an additional revenue of about Rs. 6 crores. In 1923–24, when the duty was doubled, it contributed only Rs. 3 crores. But that was due to exceptional circumstances; and we can count upon an increase of 6 crores, if the rate of duty is raised to Rs. 2-8-0 per maund.

The cotton excise duty was abolished in 1926–27. That year signalized, in the words of Sir Basil Blackett, the demise of this unlamented duty. It has now been buried, and its resuscitation would be considered almost a political miracle. And yet, if the matter is viewed from a rational standpoint, there is no reason why it should not come to life again. The Fiscal Commission hoped that, as the duty had an unhappy history, its abolition would clear the air of all prejudices, and make it possible to discuss the points at issue in the clear light of reason. Now that it has been definitely taken off, one would think that it would be possible to consider the question on its merits. Unfortunately, the apparitions of the past are still haunting us; and in the prevailing atmosphere of distrust and suspicion there is no chance of anyone, who is not prepared to agree that the duty is gone beyond recall, getting even as much as a hearing. The difficulties are stupendous; but need not prove insuperable, if we assume that the nation, under the new constitution, will rise above the limitations of the past, an assumption without which it is not possible to proceed with the discussion of any proposal of this kind. There is now no question of vindicating India's honour. We ought to look at the question simply as part of our scheme of fiscal reconstruction. The present position is easy to understand. Cotton imports are paying a duty of 11 per cent, domestic production is tax-free, and the Indian cotton industry is therefore receiving protection to that extent. This protection is merely incidental,

as the 11 per cent duty is a revenue duty. India supplies her demand for cotton goods very largely herself by mill and handloom production.[1] The Indian cotton industry is passing through difficult times; but the condition of the Lancashire and Japanese industries, which are its principal competitors, is quite as bad, if not worse, and that fact in itself need not have any weight with us. The Textile Tariff Board recommended the grant of protection only till the end of 1929–30; and as the end of that period is at hand, the presumption is that the industry will not then need any protection. It is the mills situated in Bombay which are finding it specially difficult to pull through; but as they are only 77 out of 274 mills, working in India, and their misfortunes are due to inefficient organization and the increasing competition of the up-country mills, it is not necessary to make much of the fact that they are in for hard times. They cannot be allowed to be ruined; but as the nation cannot possibly put a premium on inefficiency, their future depends, as the Textile Tariff Board pointed out, upon reorganization and the introduction of internal economies. In a year or two things ought to improve, and even for the Bombay mill-industry the outlook need not be gloomy. The real point is whether an excise duty on cotton manufactures in India is in itself essentially wrong. To this question it is possible to answer emphatically, no. The whole question turns on how the prices of imported cotton goods are related to those of the products of Indian mills. There are two alternatives. Either the latter are regulated by the former, or they are independent of each other owing to their having different markets. It is very unlikely that there is no connexion between the two. For counts between 30 and 40 they are even now substitutes for each other; and the range over which there is a competition between the two is sure to become wider in course of time. It will not, therefore, be wrong to assume that domestic prices depend upon the prices of imported goods in a very large measure. If this is so, then the

[1] India's share of the total consumption of mill-woven cloth is now about 52 per cent.

case for the imposition of an excise duty on the Indian cotton industry is irrefutable. Without it, the mill-owners will continue to make money at the expense of the consumer; and the total amount, which they will be able to put in their pockets, will come to about Rs. 7 to 8 crores. The consumer will pay 11 per cent, both on the imported and locally produced goods; but only the proceeds of the duty on imports will go to the public treasury, those on locally produced goods being appropriated by the mill-owners. In these circumstances, the reimposition of the excise duty is clearly a national duty. It is wrong to let any class of producers charge consumers higher prices merely because the fiscal needs of the State make it necessary to raise the prices of imported goods. The precise relations between the prices of foreign and Indian made goods must be studied more carefully; and if it is found that the latter are determined by the former, it would, as stated above, be wrong in principle not to impose a countervailing excise duty. But even if the prices in the home market are fixed by internal competition, there is no reason why an excise duty should not be levied on cotton industry. It is not a duty on production but on consumption, and will, of course, be passed on to the consumers. The rate of the duty will, in that case, not necessarily be equal to the import duty, but will be fixed by revenue considerations. The protection which the cotton industry is receiving now is a haphazard protection. The condition of the industry, if protection is asked for, will have to be enquired into again, and either the present import duty will be converted into a definitely protective duty, and its rate changed to suit that purpose, or the excise duty will be reimposed, and its rate will depend upon the relations between the prices of imported and India-made goods. But the presumption against an old and well-established industry, like the cotton industry, being really in need of protection is very strong, and in all probability it will be possible to levy an excise duty on the industry, and get at least three to four crores of rupees for the treasury. The annual yield of the 3½ per cent duty was nearly two crores. But there is no reason why the rate of the duty, which it may be

desirable to levy, should be 3½ per cent, and no more. It ought to be possible to have a higher excise duty. Protection without some guiding principle is, as is well known, one of the most corrupting factors in the political life of modern democracies. A democracy in the making cannot afford to play with this dangerous instrument. If it is to be used at all, it must be used under proper safeguards.

There is, of course, no reason why an excise duty should be imposed only on the cotton industry. There should be excise duties on the consumption of jute, wool, silk and other industries which are localized and are not in need of protection. It may, later on, be possible to impose excise duties on matches and sugar. Since it is necessary, in many cases, to have high revenue customs duties, a system of excise duties will have to be introduced if the discriminating character of our tariff protection is to be kept intact.

There are, as already stated, about 5,000 joint stock companies which are not paying super-tax, which in this case is really a corporation tax. This exemption has to go. There is nothing to be said for it. It is difficult to say what the withdrawal of the concession will add to the revenue. But, at the rate of one anna per rupee, a yield of about 30 to 40 lacs may be expected. It will also be desirable to levy even higher rates on companies earning larger profits. The rate may be 1½ as. per rupee on profits ranging from one lac to four lacs and 2 as. on profits above four lacs. The 1½ as. rate will bring in an extra revenue of Rs. 20 lacs, and the 2 as. rate over Rs. 2 crores. The removal of the exemption limit and the revision of rates will mean an addition of about Rs. 260 lacs to our resources. In theory, the principle of progression is not applicable to the earnings of corporations; but these may be considered as three different rates, and not three rates in the same scale. The companies, whose profits exceed 4 lacs and which are now contributing more than 2 crores out of the Rs. 2·55[1] crores of revenue from the super-tax

[1] *All-India Income-Tax Report and Returns*, 1926–27.

on companies are either public utility enterprises, or, in most cases, concerns which are enjoying special privileges. This differentiation in rates will be a step in the direction of developing different taxes for different kinds of corporations.

Any scheme for an all-round enhancement of the rates of taxation must, of course, include the income-tax as well. There are certain considerations which suggest the need of caution in this matter. In the case of the income-tax, administrative efficiency is of vital importance, and any enhancement of rate must be preceded by an efficient organization of the assessing and collecting agency. The administrative machinery of the income-tax in India is still in an early stage of development, and cannot be subjected to an unduly heavy strain. The young officers are new to their work, and have yet to develop the traditions which have made the Inspector of Income-Tax in Great Britain what the Royal Commission on Income-Tax calls 'a pivotal figure' in the whole system of the British Income-Tax. The Indian Income-Tax Act has only been recently modernized, and its provisions have still to show that they can stand the acid test of experience. But in spite of these considerations, it is undoubtedly necessary to enhance the rates. Persons, who are liable to income-tax in India, represent a much higher stratum in the social order than income-tax payers in most of the western countries. They occupy a much more elevated position in the social scale on account of the abject poverty of the masses in India. The Indian scale should, therefore, be much more steeply graduated than in other countries. The exemption limit is far above the subsistence level; but as there are no family and children allowances in the Indian Income-Tax law, and the increase of administrative work resulting from the lowering of the exemption limit will be out of proportion to the anticipated yield, it need not be changed. But the rates of tax on incomes above Rs. 2,000 should be revised. The Taxation Enquiry Committee have recommended an enhancement of rates for incomes above Rs. 10,000. There ought to be also a slight increase of rates on incomes below this limit; but on incomes above it, the increase

ought to be appreciable, and the limit for super-tax should, as the Committee here suggested, be lowered to Rs. 30,000 and the rates also enhanced. It is not necessary to draw out here a revised scale of rates. In 1926–27 income-tax collections amounted to about Rs. 11·30[1] crores, and super-tax collections from individuals to Rs. 1·69 crores. Income-tax receipts are now on the up grade; and even with the existing rates, collections ought to amount to Rs. 15 to 16 crores. The enhancement of rates should yield another five crores without involving the risk of a breakdown of income-tax administration. As remarked above, income-tax payers in India are a highly privileged section of the community, and ought to assume heavier fiscal obligations. An addition of 5 crores to their burden will not be a great hardship, in view of the fact that every section of the community is to be required to make additional contributions to speed up the pace of our national progress.

The foregoing proposals for the imposition of new taxes and enhancement of the rates of old ones are merely tentative suggestions. They make no pretence to be regarded as a definite programme of fiscal development. If they have any meaning, it is this, that the nation has to take the task of the renovation of the life of the individual and of society in India seriously in hand, and make an earnest effort to mobilize all possible fiscal resources for the purpose; further that there do exist ways of escape from the overpowering sense of futility with which we are so often afflicted. There may be alternative and better methods of increasing our public revenues. By all means let us use them, though these also will probably be found on examination to be worthy of careful consideration. What is essential is that we should give up the belief that we have come to the end of our tether in the matter of taxation. If we mean business, we must find a way of expanding our revenues and getting out of what looks like the slough of despair. It will, however, be said that there is no chance of comprehensive proposals, like those outlined

[1] *All-India Income-Tax Report and Returns*, 1926–27.

above, being passed by the Central and Provincial legislatures. They will hit so many powerful interests, run counter to such deep-seated convictions, hurt so many susceptibilities, and involve such heavy extra burdens that a student of federal finance, who bases his plans of financial re-adjustment on such impracticable proposals, may well be considered to have forfeited his right to be taken seriously. They may, as a matter of fact, be cited as an apt illustration of the extravagant lengths to which an academic student of the subject can go, once he allows his theories to run away with his judgment. This objection has to be answered; for it has great force and can be driven home very effectively. The central plan, which is very simple but has still to be elaborated, does not stand or fall by the success or failure of the particular fiscal expedients which have been discussed in the foregoing paragraphs. It certainly postulates the necessity of the enlargement of our resources; but the means by which that end can best be attained is another matter. If there are other ways of imposing additional taxation, which commend themselves to the collective judgment of our people, they will of course have to be used. As the Governor-General cannot be expected to use his emergency powers for certifying the fiscal measures which may have to be adopted, the consent of our people is indispensable for the success of this or any other plan of re-adjustments. There are difficulties, but it is possible to overcome them if two essential conditions are fulfilled. One of them is that the Government of India must restore their credit in the domain of public finance. Just now it is at a very low ebb, and their motives are freely and openly questioned. The possibility of putting on the people burdens, which they are not prepared to shoulder willingly, should be definitely put an end to. If, two years after the inauguration of the new constitution, another Lee Commission is to swoop down upon the country and impose a charge of 1½ crores on the Indian exchequer, or if spending departments like the military and the police, which are already suspect, put up their demands and appropriate revenues which are so urgently

needed for other purposes, in spite of popular opposition, or again, if money is squandered on works whose utility is extremely doubtful from the standpoint of the people, there is not the slightest chance of a programme of additional taxation, which may be adequate for our needs, being carried through. The administration must be run on the assumption that the higher services in India are, if not overpaid, getting more than the country can afford to pay, or at least that it cannot afford to pay them more; and further, that if the legislatures can bring themselves to pass measures of additional taxation, their yield will be used only for purposes which can meet with their approval. In other words, the principle of autocracy must be completely abandoned in the financial administration of India. Taxation is unpopular everywhere; but in a country, which is striving to be free, the prejudice against it becomes a part of the intellectual make-up of the people owing to their political subjection. In India, it will take years of political education to work off this legacy of the past; and any incipient tendency on the part of the people to emancipate themselves from it will be nipped in the bud if, in the allotment of funds, the objects of which they do not approve have precedence over those of which they do.

The other essential condition for embarking upon a programme of additional taxation is that political India should realize that, without it, we cannot make any headway against our enormous difficulties. Even before the war, it used to be said that the limit of the taxable capacity of the people had been reached. During the war the Government of India increased their tax-revenue from Rs. 78·21 crores in 1914–15 to Rs. 127·52 crores in 1919–20, i.e., by about 50 crores. After the introduction of the Reforms, in the two years 1921–22 to 1922–24, the Legislative Assembly voted additional taxation of over Rs. 40 crores, and the Provinces taken together realized about Rs. 14 crores in three years by the enhancement of their taxes. Our past experience shows that the country can put forth efforts for adding to the public revenues, if the circumstances necessitate it. It may, however, be said that those were extraordinary times, and,

the country cannot sustain the energy which the perils of war or of financial insolvency called forth in those critical years. This consideration, however, is less weighty than it appears. The additional taxation imposed during and after the war was really not a people's undertaking. The extra burdens had to be borne by them ; but it is wrong to say that it was an act of voluntary sacrifice, or that the obligation was assumed to avert a clearly perceived danger. The point, however, is that taxable capacity was there, and it was pressed into service by the Government. Every nation has its hidden reserves, which can be drawn upon in times of need.

Is it too much to expect that our public leaders will also exercise their powers of imagination, will realize the necessity of ushering in at once an era of national regeneration, and will call upon the nation to put its shoulders to the wheel and not grudge the payment of the necessary additional taxation. The suggestions made above, after all, involve additional taxation of about Rs. 40 crores. Such amount will not suffice even to touch the fringe of the problem of national reconstruction ; and much more will have to be found later on. But, as an earnest of our intention to do our best, it will do. This amount has to be found. If the nation needs some slogans in order that the proposals may have a popular appeal, they can easily be provided. It can be declared that money is imperatively needed to wage war against ignorance, disease, poverty and the numerous other evils which are eating into the vitals of our nation. Ours is a poor country, but it need not abandon all hope on that account. Once people know that they will get a good return for the money that they are asked to give, and their leaders set them a good example by first taxing the classes to which they themselves belong, the enthusiasm necessary for carrying out a programme of additional taxation will not be lacking. This is an essential condition of the success of these proposals; and it is up to our educated classes to ensure that it is provided.

We have, however, not dealt with the real problem to which this chapter, if its heading is not misleading, is

to be devoted, i.e. the problem of re-allocation of resources. Indirectly, a solution of the problem has been suggested. It may now be specifically stated that, on administrative grounds, the Provinces must be left in charge of the sources which have been assigned to them under the existing arrangements. Two new taxes will also be administered by them. These are the tobacco duty on vend and the tax on the capital value of land. It is also possible to assign to them the yield of the inheritance tax which, however, will be administered by the Central Government. It will take some time for these taxes to get into proper working order, and their yield is uncertain. If a guess is to be hazarded at all, it may probably amount to about Rs. 15 crores. It is impossible to say how far each Province will be helped by their introduction; and as the revenue which will be derived from them is of a speculative character, the Provinces will need some other additional resources in order that they may face the immediate future with the assurance of being able to do something. The Government of India will administer all the more elastic sources of revenue. The normal tendency of their receipts to expand will give them a surplus. But that by itself will not carry us very far, and it will be necessary to revise the existing taxes, and impose some new ones. It is, as already stated, possible to hold divergent opinions regarding the taxes which ought to be levied or enhanced; but those mentioned above are probably not much worse than others that can be utilized for the purpose. At any rate, they can do us service in illustrating the method by which larger funds can be placed at the disposal of the Provinces. It is certain that the only way in which this can be done is that a part of the revenue, collected by the Central authorities, should be assigned to the Provinces. The yield of the additional taxation suggested above will amount to about Rs. 25 crores, and comprise :—

| | Rs. Crores |
|---|---|
| Import duties... ... ... ... | 3 |
| Export duties ... ... ... | 2·5 |
| Excise duties, including tobacco, kerosene, cotton ... ... ... ... | 6 |

| | Rs. Crores |
|---|---|
| Salt tax ... ... ... .. | 6 |
| Corporation tax ... ... ... | 2·5 |
| Income-tax ... ... ... ... | 5 |

These figures, though not imaginary,* are merely illustrative; and their claim to precision is strictly limited. The cardinal point is that this amount, and the surplus that may be realized by the process of normal growth, is to be handed over to the Provinces for meeting their needs.* Some of it may be set apart for securing co-ordination, but the bulk of it must be transferred to the Provinces for developing the important services for which they are and will remain responsible. How is the transfer of funds from the Central to the Provincial exchequer to be effected? This is a most important aspect of our enquiry; and as it can be more conveniently dealt with in the next chapter, this chapter may be closed with the general remark that, in handling this issue, we must rise above the prejudices, which we may have inherited from the past, and all narrow parochial considerations. It is only from the elevated plane of the well-being of the nation as a whole and equity, of course, that we can do full justice to this question.

# CHAPTER VII

## *The Redistribution of Revenues*

In this chapter we are mainly concerned with the problem of finding a method or methods by which funds can be transferred from the Central Government to the Provincial Governments. But before we take this up for consideration, it is desirable to see whether it is not possible to increase the Central revenues, by means other than additional taxation, the necessity of which has been emphasized already and need not be further stressed. Public opinion in this country is likely to discount the utility of any scheme, which does not provide for the reduction of expenditure as one means of increasing the spending power of the State for the promotion of objects like education, sanitation, etc. It has already been stated that economy, though highly desirable, cannot carry us very far; and the cost of revision upwards of the salaries of the lower services will more than neutralize any economy that may be effected by reducing the scale of salaries of the higher services. But there is one head, the expenditure on which is regarded as so much out of proportion to the economic resources of the nation, that it is impossible to convince even the most reasonable student of public affairs that economy can be of no avail in solving our financial problem. The head on which the expenditure is so universally regarded as inordinately high, is, of course, Defence. The issue is political rather than financial; and as the divergence of opinions regarding the right scale of military expenditure is due to a fundamental difference of standpoints, the issue must be discussed in the light of those premises.

From the Indian point of view, there is only one aspect of the matter which is really important; and that

is that, if India is to be a free country, she must have her own national army. The Indian Army, as it is constituted to-day, is not a national army in any sense of the word. It is an army of occupation, and the British element in it is a constant reminder of the fact that India's connexion with the British Empire rests ultimately on force. It is humiliating for any self-respecting nation to have to put up with large contingents of foreign troops as a guarantee of her own safety. Any scheme of self-government, which is not to be a hollow sham, must, therefore, make provision for rapid Indianization of the army. The national army in India must be manned and officered by Indians and only by Indians. The British section is the most costly portion of our army, and its elimination will mean very large savings. It is also generally assumed that, as the Indian army is maintained, not only for the defence of India, but also for Imperial purposes, the gap caused by the withdrawal of British troops need not be filled. This is a purely hypothetical assumption, and how far British troops will have to be replaced by Indian troops is a question which has never so far been carefully examined. The Indian army, however, is, at present, a part of the Imperial Defence forces; and it is probable that its numerical strength will be reduced if India, in the future, has to provide only for her own defence. She will, of course, contribute her own share to the expenditure, which may have to be incurred, for the defence of the Empire; but as a scheme for the purpose has still to be evolved, that need not be regarded as an imminent liability. The reduction of our military expenditure is inevitable if the new constitution is to prove, as has often been foreshadowed by responsible statesmen, a basis for a final settlement between Great Britain and India, and to contain in itself the germs of its own evolution. This saving will be a direct outcome of the constitutional changes, and its accrual must be regarded as an integral part of the impending developments. It is, however, impossible to forecast with any degree of precision the amount of this saving; and even the most sanguine amongst us must admit that the process of Indianization will have to be spread over

years. Moreover, the quicker the pace at which this liquidation of the past proceeds, the less will be the possibility of our adding materially to our resources by such means in the immediate future on account of the heaviness of the terminal charges. The scheme of financial readjustments outlined in this book, though based in its principles on intelligent anticipation of even the distant future, is in its details only concerned with the next step in our financial evolution; hence the savings that we may be able to realize by the progress of Indianization of the army cannot be taken into account in discussing the immediately possible methods by which we can finance schemes of national development. The savings, as stated above, will be large; but in the immediate future they will not be a factor of any importance in the distribution of revenues between the Central and Provincial Governments.

It cannot be maintained, however, that there is no room for further economies in military expenditure, even apart from this wider issue. Since 1924–25 military expenditure has been practically unchanged. After the economies realized in 1923–24, on account of the cuts recommended by the Inchcape Committee, no efforts have been made to reduce this expenditure. As is pointed out in the memorandum on military estimates every year, it is well below the limit of Rs. 57 crores, fixed for established charges by the Inchcape Committee; but, at the same time, it is well above the limit of Rs. 50 crores which, as is well known, was the figure to which the Committee expected that expenditure would be automatically reduced by the fall of prices and other economies. Prices have fallen since 1922–23; and, in particular, the English charges debited to the military estimates have been reduced by the rise in the exchange value of the rupee on account of its stabilization at 1*s*. 6*d*. The revision of the pay of British soldiers, which gives reduced rates to all new recruits after October 1925, has resulted in a large reduction of the liability on this account; and its full cumulative effect on the military estimates has not been realized as yet. The Inchcape Committee did not recommend any

reduction in the expenditure on the Air Force since they anticipated that the extended use of this new arm would result in economies in expenditure on ground troops. Since then the expenditure on the Air Force has increased from Rs. 1·10 crores in 1922–23 to Rs. 2·6 crores in 1928–29; but still the expenditure on the other fighting services is the same as before. The military authorities appear, as a matter of fact, to have taken for granted that Rs. 55 crores is their block grant; and any reduction of expenditure that they can realize is being utilized for improvements of all kinds. The Inchcape Committee, while recommending the reduction of military expenditure to a sum not exceeding 50 crores, emphasized the necessity of keeping a strict eye on military expenditure, with a view to its further reduction even though revenue might increase through a revival of trade. This is what the Government of India have not done. They seem, as remarked above, to have taken it for granted that so long as military expenditure does not exceed Rs. 55 crores, it is not incumbent upon them to exercise any pressure on the military authorities for reduction of expenditure. It is necessary that they should take an entirely different view of the matter, and should realize that Rs. 55 crores is much more than the tax-payer should be called upon to pay, and that though the era of deficits is now at an end, the need for exercising the utmost vigilance in the direction of reducing military expenditure is as urgent as ever. The necessity of the Government of India winning the confidence of the general public in matters of finance, as an essential condition of stimulating the nation to adopt a different view of taxation, was referred to in the last chapter. The most convincing way in which the Government of India can establish their *bona-fides* is to demonstrate their willingness to participate in a truly national campaign for increasing the resources available for the vital services by making an appreciable reduction in their expenditure on defence. It is not possible to indicate the limit to which such reduction could be made. The figure of Rs. 50 crores, adopted by the Inchcape Committee, is based neither on a careful calculation of what India can afford to spend nor on an

estimate of our minimum military requirements. No special significance need, therefore, be attached to it. But the Government of India must undertake a thorough scrutiny of the military estimates, and put an end to all unnecessary or wasteful expenditure with a rigorous hand. It is difficult to say how the Government of India will be reconstructed under the new constitution, but even if they are not fully responsible to the legislature, they will have to be much more responsive than at present to the demands of the articulate voice of India. Mr. Gokhale used to say that the Government of India should be national in spirit even though they might not be national in personnel. The Government of India will have to be national even in personnel to a much greater extent than they have ever been before ; but if they do not also imbibe the national spirit, and appreciate the imperative necessity of bringing themselves into unison with the impulses of what is called the Indian renaissance, the outlook for the country is gloomy indeed. One tangible proof of this change will be their readiness to meet public opinion more than half way with regard to the reduction of military expenditure. It is not possible, as remarked above, to state definitely what amount can be realized by these economies ; but for our present purpose we may assume that it will not be less than Rs. 5 crores. This is an arbitrary figure ; but it is difficult to make it lower, if it is to be taken as an indication of an earnest resolve on the part of the Government of India to go as far as they can in the direction of creating an atmosphere favourable for the success of the required programme of additional taxation.

In 1925-26 a definite scheme of debt redemption was brought into operation ; which was, in the first instance, to be tried for a period of five years. Under this scheme, a sum of Rs. 4 crores, and such additional sum as is equal to one-eightieth (on the assumption that this will be productive debt) of any excess shown in the total of the debt outstanding on 31 March of the preceding year over the total outstanding on 31 March, 1923, is provided every year for the reduction or avoidance of debt. The scheme* aims at the extinction

of the productive debt of India in 80 years, and of the unproductive debt in varying periods of 15, 25 and 50 years, according to the purpose for which the debt was incurred. But the actual progress in the reduction of debt has been much more rapid than that which is required by this time-scale. The unproductive debt of India, as already mentioned in Chapter III, has been decreased by Rs. 72 crores; and according to Mr. E. Burdon, Finance Secretary to the Government of India, it will vanish altogether in another eleven years if the present rate of progress is maintained.[1] Every year, the addition of one-eightieth is made in view of the increase in the productive and so in the total debt. In 1928–29 the total amount provided for the amortization of debt amounted to Rs. 5·40 crores. On 31 March, 1928, the productive debt of the Government of India stood at Rs. 686·54 crores, and the unproductive at Rs. 178·73 crores. A very large portion of the amount provided for debt redemption is thus intended to cover the repayment of productive debt, and indeed this latter amount has increased by Rs. 1·78 crores from 1923–24 to 1928–29. This policy of debt redemption is held to have been a great success; and the improvement in the credit of the Government of India, the rise in the price of Government securities, and the reduction in the interest charges on deadweight debt are attributed to it and to the strenuous efforts made to secure budget equilibrium. The Government of India can now borrow at a lower rate of interest, both in India and in England, the prices of Government securities have gone up; and the aggregate interest charge on unproductive debt has fallen from Rs. 15·97 crores in 1923–24 to Rs. 9·51 crores in 1928–29. The Provinces have, of course, been benefited by this all-round improvement, as they have done most of their borrowing through the Government of India. In the face of these facts, it would appear to be the height of unwisdom to suggest that this policy should not be proceeded with, or the provision for the reduction of debt diminished.

[1] *The Government of India Budget*, 1928–29, p. 50.

A raid on the sinking fund, when the financial position of the country is satisfactory in every respect, will be deprecated; and it will be urged that it would recoil on the public credit of the State, and in its consequences will be a real boomerang. It is not easy to dissent from this view, but still there are some considerations which do not point to the same conclusion. In the first place, it is not certain that all this improvement is due to the operation of the debt redemption scheme. The bulk of the amount provided under it represents contractual obligations. In 1923–24 they accounted for Rs. 3·72 crores; and out of the total provision of Rs. 5·40 crores in 1928-29, these obligatory payments amounted to Rs. 4·31 crores. The optional amount of redemption, it would thus appear, for which credit can be taken by the introduction of this scheme, is not very large; and it is not unlikely that the economies which the Government of India have been able to realize as a result of lower interest charges are due far more to budget equilibrium, the stabilization of exchange and the general economic recovery of the world as a whole than to the effects of the adoption of this scheme. The bulk of this provision would have had to be made even if, to use the words of Sir Basil Blackett, 'a regular programme based on stable and well considered principles, not subject to haphazard changes' had not been adopted. There has, it is true, been an increase in the provision made for the redemption of debt during the last six years, as stated above, of Rs. 1·78 crores; and it may be conceded that this has, to a certain extent, exercised a wholesome influence on the general position. It would be wrong, however, to say that, but for the adoption of this scheme, the large saving which has been effected in our debt service would not have materialized.

It is, moreover, impossible to maintain that the policy of amortizing the productive debt in a country like India is not open to question in principle. As regards the revenue surpluses of the first decade of the twentieth century Mr. Gokhale was wont to criticize severely the policy of using these for the reduction of debt, and earnestly urged upon the Government of India the

necessity of utilizing them in 'vigorous and statesmanlike efforts for the promotion of the material and moral interests of the people'; but the same Government, which turned down his proposal for the introduction of free and compulsory elementary education on the ground that it was 'extravagant and impracticable', spent more than Rs. 100 crores from 1900–01 to 1914–15 for the reduction of debt, and had almost succeeded in extinguishing our unproductive debt before the war. This was possibly right from the standpoint of strict financial orthodoxy, but it must be regarded as extremely bad economy from the national standpoint. These pre-war surpluses, moreover, were used, after all, for the reduction of unproductive debt; but the scheme, which is now in operation, makes permanent provision for the progressive reduction of our productive debt, and the debt redemption charge on this account is likely to increase every year. The prospect of our acquiring a fee simple of our railway property, in due course, has a charm of its own; but to a country whose people are steeped in poverty and ignorance, and where, on account of the ravages of disease and the absence of elementary sanitary arrangements, life itself is so precarious, the value of this investment is bound to appear exceedingly doubtful. The redemption of debt cannot be left to accidents. There ought to be a stable policy, and a well-considered programme; but whether this should include provision for the liquidation of debt, against which we hold valuable assets, is a proposition whose soundness cannot be accepted as a matter of course. In Australia the debt of the States, most of which is productive, is, under the scheme of 1926-27, to be extinguished at the rate of ½ per cent every year. In India, we propose to pay off our productive debt at the rate of 1·20 per cent every year. This would probably be considered a very liberal provision in any country of the world. Great Britain is repaying her debt of over £7,000 millions, the whole of which is war debt, by a sinking fund of £50 millions every year; i.e. about 1/140 of the debt is to be annually liquidated under this scheme. In the opinion of the Colwyn

Committee, the provision of £50 millions a year out of revenue is insufficient; and they recommended that the sinking fund should as early as possible be increased to £75 millions a year, and the aim should be to increase it to £100 millions per annum.[1] This is the outside limit up to which they are prepared to go, but they do not recommend that it should be reached at once. Even if the sinking fund is raised to that figure, Great Britain will be repaying about one-seventieth of her debt every year; and that is only a little more than the provision, which has been made under the scheme of 1925, for the repayment of our productive debt. The total debt of the Government of India in 1928 was Rs. 846·27, i.e. in round figures, about £650 millions, and less than the pre-war unproductive debt of Great Britain, so that our provision, judged by that standard, is really very satisfactory indeed. The Provincial debt in 1928 amounted to Rs. 126·34 crores; and as the whole of it is productive, it is also proposed to pay it off in eighty years. Sir Basil Blackett, in speaking of the advantages of this scheme, once said that he had always been a financial purist, and that events had justified his policy of unswerving rectitude. Financial purism is a great virtue; but it looks as if, in India, we were going to have too much of this estimable quality.

But there is yet another consideration which has an important bearing on this aspect of this question. The productive debt of the Government of India consists of Railway debt, debt of other commercial services and Provincial debt. As the Provinces are making their own provision for sinking fund, their debt can be left out of account. The remaining productive debt is mainly Railway debt, that has been incurred for railway construction. Now the railways are an autonomous undertaking. They have their own assets, their own liabilities, their depreciation fund, and are building up their reserve fund. Sir Basil Blackett, in his Budget speech of 1925, speaking of the Provincial Loans Fund,

[1] *The Report of the Committee on National Debt and Taxation*, 1927, p. 341.

said: 'The scheme contains within itself the germs of development; and I look forward to the day when the Fund may be administered by an Indian body corresponding to the National Debt Commissioners or Public Works Loan Commissioners in England, and the money required for the advances from the Fund raised in the open market by the controlling body on the security of the assets of the Fund. Not only these advances to the Provincial Governments, but also the Railway debt of the Government of India, may ultimately be separated from the ordinary debt, and raised, subject perhaps to a Government of India guarantee, not on the general credit of the revenues of India, but on the security of the assets of the Provincial Loans Fund, and of the Railway undertakings of the State, respectively.' The development, foreshadowed by Sir Basil in 1925, must now be realized; and the proposal outlined in the next chapter will, if it is given effect to, lead to that result. The Railway debt will then be raised on the security of Railway assets, and will be placed on the same footing as the Provincial debt. The Provinces now provide their own sinking fund, and will continue to do the same in the future. There is no reason why the Railways should not do likewise, and be made responsible for providing their own sinking fund. This is an obligation which they have to assume as a necessary concomitant of their being an independent corporation. Till 1923 Railway annuities were a charge on Railway receipts; but now they are being paid out of ordinary revenues, and in 1928 a charge of Rs. 1·73 crores was thrown on the Indian exchequer on this account. The transfer of this charge from Railway receipts to general revenues involves an unwarranted burden on the tax-payer, and is against the spirit of the convention of 1924, according to which railway finance was separated from general finance. The same consideration applies to Railway sinking funds, and other such charges for the redemption of productive debt, on the revenues of the Government of India. The contribution from Railways to general revenue in 1928 amounted to Rs. 5·23 crores; and as the tax-payer had to provide Rs. 5·40 crores for sinking funds in that year, the bulk

of which was due to Railway debt, the net gain to the treasury by the operation of the Convention of 1924 was, comparatively speaking, inconsiderable. This convention and the Debt Redemption Scheme of 1925 are now both due for revision. One necessary change, which has to be made, is that general revenues should be relieved of the charge of making provision for Railway sinking funds, and the liability, if it is to be continued, should be met out of Railway receipts. This is obviously an eminently fair arrangement, and ought to be introduced. Such a change would, in 1930, give relief to general revenues to the extent of about Rs. 5 crores, and also prevent practically any increase in the charges for debt redemption.

Now we can take up the question of increasing the resources of the Provincial Governments by transferring revenue from the Central to the Provincial exchequer. The Government of India will, according to the illustrative figures referred to at the end of the last chapter, have a surplus of Rs. 25 crores from taxation; and if they reduce their military expenditure by Rs. 5 crores, and if general revenues are increased by another five crores by making the Railways responsible for providing their own sinking funds, the total surplus will amount to Rs. 35 crores. Admitting once more the semi-hypothetical character of this figure, we can now proceed to discuss the method or methods by which this amount is to be placed at the disposal of the Provinces. There is one consideration which is of supreme importance from the point of view of the country as a whole, and ought to be specially stated. Whatever scheme of fiscal re-adjustment may be adopted, it should make provision for giving adequate resources to all the Provinces, and should therefore take into account the existing disparity in their financial strength. It is not necessary to restate why this consideration is all-important. If India is to be a united nation, she has to look to the needs of all her constituent units, to ensure that they all maintain a certain level of development and progress, and to redress, as far as possible, the unequal advantages which are a drag on the progress of some Provinces, and

are due to historical causes. The best way to help the Provinces is, of course, to get them to help themselves; but that does not rule out of court the possibility of making an adjustment such as will suit the special features of the problem in India. Indeed, it may be necessary to accord special treatment to particular Provinces if their resources, in spite of their best efforts, are inadequate for attaining the national minimum. This should be the limiting factor in every scheme of the re-distribution of revenues. The Government of India have to give, and the Provinces have to receive; but this transfer has to be effected in such a way as to make it possible for the latter to perform their functions with due regard to the entire national economy.

One method for the transfer of revenue from the Central to the Provincial treasury, which is likely to suggest itself readily, is that the yield of income-tax should be allotted to the Provinces. The present yield of the personal income-tax is about 12 crores,[1] and an increase of five crores may safely be counted on, whether as a result of normal growth or enhancement of rates. The Government of India can easily do without it, if the assumption that it can increase its resources by about Rs. 35 crores may be taken as correct. Provinces like Bombay and Bengal will welcome this change, as till now they have been asking for a part of the income-tax revenue, and will be glad to get the whole of it. As the administration of the tax will remain Central, its efficiency will not suffer; and there will be no multiple taxation, as there will be uniformity of rates all over the country. There will be some conflict between the principles of situs and domicile in the allocation of receipts among the Provinces; but, if there is reciprocal exemption of non-residents, this difficulty will be surmounted. It may even be necessary to modify this method in the interests of Provinces like Assam, Bihar and the Central Provinces whose resources are being exploited by outside enterprise; but it may not be impossible to devise conventions by which a rough

[1] This amount does not include the amount credited to 'India-General'.

equity may be attained. Even then the transfer of income-tax receipts to the Provinces will not be a solution of the problem. In 1926–27 the total yield of income-tax and super-tax on individuals was distributed among the Provinces as follows:—Madras Rs. 1·18 crores, Bombay Rs. 2·83, Bengal Rs. 4·23 crores, United Provinces 63 lacs, the Punjab 65 lacs, Burma Rs. 1·51 crores, Bihar and Orissa 53 lacs, Assam 18 lacs. The enhancement of rates will not change the relative position of the different Provinces; but the adoption of conventions for the allocation of receipts between the Provinces of origin and residence will make it possible for the Provinces, whose receipts are now the lowest, to improve their position. That, however, will not lead to any complete adjustment of their resources to their needs. The Provinces which will really gain most will be Bengal and Bombay, and the addition to the resources of Burma and Madras will also be considerable. But the other Provinces will not get much by the adoption of this method; and, leaving aside the Punjab, these are just the Provinces which are very much undeveloped, and where the pace of progress has to be specially accelerated. It will bring to Bengal very great relief, which it needs badly; but the problem of re-adjustment is not confined to that Province. It may, however, be urged that the industrial Provinces of Bengal and Bombay are entitled to receive what they will get under this arrangement, for they will get what they produce; and moreover, it will compensate them for the fact that the agricultural Provinces gain on account of the provincialization of land revenue. The latter point may be taken up first. Bengal gets only a little over three crores out of land revenue; but that is certainly not due to the fact that it is not an agricultural Province, and consequently the question of compensation does not arise. Bombay derives more than five crores from land revenue and taking into account its population and cultivable area, that is not at all a poor yield. It is, indeed, larger than that of the Punjab (where, however, the amount credited to the land revenue account is low, as a large portion is shown as revenue due to irrigation); and the Punjab is

*par excellence* an agricultural Province. The income from land in the United Provinces and Madras is higher than that in Bombay but, not very much higher; and as each of these Provinces has more than twice the population of Bombay, it cannot be said that the differences[1] represent any special advantage. The land revenue income of other Provinces is less than that of Bombay; and, therefore, the general belief that the latter has suffered on account of the provincialization of the land revenue is not based on facts. The land revenue yield *per capita* in Bombay is higher than in any other Province except Burma; and though that is also the measure of its incidence, it is, at any rate, clear that Bombay cannot have a grievance on the score that the arrangement under which land revenue is Provincial and income-tax is Central is specially prejudicial to it. The whole argument is based on a misconception. There are no agricultural or industrial Provinces in India in the sense in which the Eastern States in the U.S.A. are industrial, and the Western States agricultural. All the Provinces are agricultural; only in some of them there happen to be situated the gateways of India, through which the whole trade of the country has to be carried on. Industrial beginnings have also been made in some Provinces, and these do not in all cases owe their existence and development to the people of the Province in which the industries have been established. In a country, in which out of the total population of 247 millions only 1·5 million persons are employed in factories subject to the Factories Act, the distinction between agricultural and industrial Provinces has no meaning; and the question of the allocation of revenues cannot, therefore, be discussed as a question of industrial versus agricultural Provinces.

But still it may be maintained that there is no comparison between the yield of income-tax in Bengal and Bombay and its yield in other Provinces, and that it is

[1] In 1927–28 the land-revenue receipts of Bombay were Rs. 5·30 crores, of the United Provinces 6·92 crores, and of Madras Rs. 7·55 crores. Tables XXXIII, XXIX and XXX.

not unfair to let them appropriate the receipts which are assessed and collected by them. It will, however, be admitted that the receipts which are collected in these Provinces are not all theirs by right, owing to Calcutta and Bombay merely being the head-quarters of concerns operating in other parts of the country. Apart from the necessity of making adjustments on this account, it ought also to be admitted that the economic importance of Calcutta and Bombay themselves is due to factors whose scope is national and not Provincial, and the Provinces of Bengal and Bombay cannot claim that the economic prosperity of these great commercial centres is of their making. Sir James Westland, in his speech in the Legislative Council on 27 March 1897, referred to the theory that each Province was entitled to get a large share of the revenue collected there, and pointed out the futility of any such contention. He said, 'Bengal is a wealthy country, which has many large cities, but its wealth is derived from the fact that it lies in such a position that the wealth and trade of other Provinces drain through it. The revenue of Bengal cannot be justly claimed by the people of Bengal as entirely appropriable to their own purposes, but must be considered at least with reference to the claims upon them arising out of the administration of the Provinces further away. I am taking Bengal only as an illustration, but exactly the same arguments apply to the Provinces of Madras and Bombay. They are all territories which derive their wealth from the fact that they lie between a hinterland and the sea, and through them the wealth of the hinterland passes to the seaboard.'[1] This argument against the exclusive right of Provinces like Bengal and Bombay to the benefit of revenues raised within their territories has now much greater force than it had thirty-three years ago, for customs duties and income-tax at that time occupied, relatively speaking, an unimportant place in our fiscal system, and the importance of Calcutta and Bombay as all-India cities has greatly increased during this period. Since then Karachi has risen in importance ; and it has a

[1] *The Welby Commission Report*, vol. III, p. 370.

bright future on account of the additional five million acres, which will be brought under cultivation after the completion of the Sukkur Barrage, and of the further development of the Punjab. Again it is the economic progress of the country as a whole and its growing integration which increase the importance of these nerve centres of economic life, and enable them to draw wealth from all parts of the country. The wealth of these Provinces is, in a very large measure, what may be called a national surplus; and the income-tax revenue which it yields, therefore, rightly belongs to the country as a whole. It is futile, as already remarked, in the first chapter, to try to establish a correspondence between benefits and costs in making fiscal re-adjustments. The development of the economic system has made such an attempt out of accord with the facts of the situation; and the future trend of events will throw into even bolder relief the utter impossibility of making any such attempt.

To revert, however, to the consideration with which we began, the assignment to each of the Provinces of the yield of income-tax is not a solution of the problem, as it gives very little to the Provinces, in which the need of development is most pressing. Moreover an assignment of Rs. 17 crores to the Provinces taken together will by no means exhaust the possibilities of increasing the latter's resources. The Government of India will, it has been assumed for the sake of argument, have a surplus of Rs. 35 crores; and as the additional revenue derived from customs and excise duties, the corporation tax and from savings on military and interest charges cannot be allocated among the Provinces on any basis of yield at all, it will be necessary to utilize some other method for handing over to the Provinces, what will, in the first instance, come into the hands of the Government of India. Indeed, even in the case of income-tax revenue this method of allotment is inherently defective from the national standpoint, and will in itself be inadequate for effecting a transfer of resources; hence it is necessary to turn to other alternatives for the re-distribution of revenues.

Another method, which can be suggested for increasing the Provincial resources, is that the revenue derived from export duties should be handed over to the Provinces. At present, there are two important export duties, i.e. the duties on jute and rice. The primary justification for levying these duties is that they are duties on a national monopoly and semi-monopoly, and that their incidence is mainly on the foreign consumers. The duties on tea, lac and oilseeds, the imposition of which has been proposed in the last chapter, will also be of the same character; and the revenue raised will, partly at least, be at the cost of the foreign consumer. The Provinces, in which these articles are mainly produced, cannot claim these receipts on the ground that they are abstracted from the total income of their citizens. The argument against the assignment of the revenue of export duties to the Provinces put forward by Sir Basil Blackett in his speech in the Legislative Assembly on 8 March 1928, is one that must be taken into account in the consideration of this question. He pointed out the undesirability of the Provincial Governments depending upon export duties for their revenue, to any considerable extent, owing to the Government of India 'having to deal with the jute duty, or an export duty of any kind, at a moment when world conditions may have made it desirable in the economic interests of everybody that the duty should be abolished'. But the reason which is most conclusive for our purpose is that the provincialization of the receipts of export duties will not give relief to all the Provinces, and particularly to those Provinces whose difficulties are the greatest. In 1927–28 the export duties yielded Rs. 4·59 crores, of which rice yielded Rs. 1·06 crores and hides and skins Rs. 37 lacs. If the revenue of these duties is to be given to the Provinces, the only two Provinces which will gain will be Bengal and Burma, though in very different proportions. Bengal will, of course, be happy under this dispensation; but the other Provinces will not feel its beneficent character. Burma will get 90 per cent of the revenue from rice, but it will be such a small sum in comparison with the yield of the

jute duty, that it will give it very poor satisfaction. It will not be possible to allocate the small sum of Rs. 33 lacs derived from the duty on hides and skins; and the receipts from export duties on lac, tea and oilseeds, if they are to be imposed, cannot be fairly allocated either, though the predominant interest of Bihar and Orissa in lac, of Assam in tea and of Madras in oilseeds can easily be demonstrated. The total revenue of Rs. 9 crores will, moreover, be insufficient for provincial requirements, and it will be necessary to utilize other methods. On account of these considerations, the yield of export duties must also go to the national exchequer.

As it is out of the question to suggest that the yield of import and excise duties, which are the only sources left, if income-tax and export duties are to be wholly central, should be apportioned between the Central and Provincial Governments, the only method by which it is possible to supplement Provincial revenues is to make assignments to the Provinces and grant them, if necessary, subsidies and subventions for specific purposes out of the consolidated fund of the Government of India. It has already been stated that such payments are made by the Federal Government to the States or the Provinces in all federal States; and they are a factor of growing importance in their finances. But, in India, reference to this method is likely to recall to our minds evil memories of the years of centralization; and we shall be very suspicious of any contributions by the Central Government to the Provinces which may bear even a slight resemblance to what used to be called 'doles', and which, as everyone admitted, were used as instruments for increasing the control of the Government of India over the Provincial Governments. Under the Government of India Act, it is not considered permissible to incur expenditure from Central revenues for expenditure on a Provincial subject, except in so far as such expenditure represents payment for services rendered by the local Government.[1] This rule is taken to derive its authority from section 21 of the Act; and is clear evidence of the fact that any

[1] *Book of Financial Powers*, p. 1, note.

payment by the Central Government to the Provinces, which is not merely in the nature of a *quid pro quo*, is regarded as subversive of the whole structure of our political constitution. In India, the Government of India has been and is supreme ; and besides being the highest executive authority of the country, it is the agency through which the Secretary of State, as the minister in charge of Indian affairs, exercises the powers of superintendence, direction and control over the whole Indian administration on behalf of the British Parliament. The control of the Government of India, therefore, is not the control by a national Government over the component parts of a federation, but the control of one nation over another, one of which has been claiming and still claims to be the final arbiter of the political destiny of the other. The Provincial Governments are much more amenable to the control of the people and will, it is expected even by the most cautious advocates of political advance, be made almost completely responsible to the elected legislatures. The Government of India, on the other hand, is still autocratic ; and though an element of responsibility may be introduced into its constitution in the near future, it is extremely improbable that it will become a national Government in the real sense of the word. It will have to cultivate more and more the habit of enlisting the co-operation of the Indian public in framing its policies in matters of importance ; but it can scarcely be hoped that it will cease to be the visible hand of the Providence, which has placed Great Britain in a position to exercise control over the life of our people. We have not the strength, and the British people have not the disposition, to put an end to this preordained relation ; and consequently, in the discharge of its constitutional responsibilities, the Government of India will have the power to enforce upon us decisions, which may not be palatable to us, but will have to be accepted as the decrees of the ruling nation. The control of the Government of India will, apart from being contrary to the federal principle in case it is excessive, be open to objection owing to the undemocratic and un-national character of the constitution

and functions of Government. It is, therefore, natural that payments by the Government of India should be viewed with great misgivings; and a scheme of financial re-adjustment, which gives them an important place in its working, may, whatever its other merits, fall through on account of this cardinal political consideration. The objection is serious, but need not be fatal to the success of such a scheme if we take a realistic view of the matter. The Government of India will, in spite of its dual character, be our Central Government and has, in due course, also to be our National Government. When it will shed its dual character, and become only the custodian of national interests, in our political system, will depend solely upon our own inherent capacity to determine our political future. But this transformation should not take very long; and in the meanwhile we must discriminate between the essentials and non-essentials, must not condemn measures and policies because of their misleading appearances, and must be prepared to work compromises which will, when we are masters of our own house, develop into the means of preserving the integrity of our national life. Assignments must inevitably be an important feature of our federal finances, because without them it is not possible to evolve a system which may really be adequate for our needs; and it is wrong to refuse to use them merely because they can be mistaken for distant cousins of the 'doles' of the pre-war period. That, of course, means that in actual practice these payments should not be capable of being used for thwarting, directly or indirectly, our dearly cherished political ambition of getting autonomy for the Provinces. That is an important consideration, and has to be borne in mind in the elaboration of the scheme of fiscal re-adjustments, under which the Provinces are given larger revenues in the shape of contributions from the central treasury.

It was stated, at the end of Chapter V, that payments made by the federal Governments to the States in other federal States can be conveniently classified under three categories—assignments, subsidies and subventions—and are to be differentiated according as they are or are not

made for specific purposes, and involve or do not involve control of the States by the federal Government. Assignments may be taken to signify payments which are made for general purposes, and do not involve the control of the States by the federal Governments. Subsidies is a somewhat unsatisfactory name for payments, which are made for specific purposes, but do not materially affect the autonomy of the States; and payments made by the federal Government to the State for specific purposes, and with definite stipulations regarding the objects and the manner of their expenditure, may be called subventions. The Government of India used to make adjusting assignments to the Provinces, under the pre-Reforms financial settlements, to make up for the deficiency of receipts from the divided heads. They were open to objection on the score that they were fixed, and introduced an element of rigidity in Provincial finances; but they were never criticized as instruments of centralization. Assignments, general and special, in other countries are received by the States as a matter of right, and are not objected to anywhere on the ground of their centralizing effect. Subsidies imply a possibility of control in theory, but can be granted in such a manner as to avoid any material reduction of the power of the States in actual practice. Subventions should be made primarily for the purpose of co-ordination; and though the line which divides co-ordination from control cannot, as already stated, be clearly defined, the distinction between the two is real, and can be made operative in the execution of policies. The objection, therefore, that contributions by federal Governments to the States give a handle to the former to interfere in the administration of the latter does not hold good in all cases; and its force can be considerably diminished by introducing proper safeguards in those cases, where they have a tendency to produce that effect. This is, therefore, not the most serious difficulty in the way of their being made an important feature of our new financial settlement. But the grant of assignments, subsidies and subventions is supposed to be open to another objection, which is, in the words of the Decentralization Commission, that 'there is

no readily available criterion by which grants of this character could be distributed in a manner which would be recognized as generally equitable'. Federal contributions in other federal States are paid to the States on a number of different bases. They are, in some cases, compensatory assignments, and are made either because the States concerned have to labour under special disadvantages or assume special obligations, which are not undertaken by other States of the federation. In such cases, of course, the only criterion which can be adopted for the assignment of funds is the extent to which these special disabilities or functions involve pecuniary loss to the States in question. Special assignments to particular States, on account of their straitened finances, are also granted on the basis of their needs. It is more difficult to calculate the amounts payable on this ground than those which are made by way of compensation, for it is not easy to estimate how far a particular State can be considered rightfully entitled to special assistance at the expense of the federal exchequer. These grants are generally lump sum assignments, and are made to prevent the States concerned from falling below the other States in their level of administration. A rough measure has usually to suffice for the purpose; though in certain cases it may be possible to frame a self-acting formula on the basis of the deficiencies of these States in respect of the vital services, and vary the grants in inverse ratio to the level of development attained. When such a basis is adopted, it is desirable that the grants should either be made for a limited period in order to give time to the States to make the necessary re-adjustments, or in such a way as to stimulate them to a strenuous effort to help themselves. General assignments are usually made on a *per capita* basis. The objection against such grants is that their amounts are larger in the case of the States which are thickly populated and, therefore, generally prosperous States, and are comparatively scanty in the case of sparsely populated and undeveloped States. The device adopted in Canada for meeting this objection is that the capitation allowance is reduced as the population

increases ; but it is not fully effective for the purpose, as it is not possible to draw up a scale perfectly graduated according to the decreasing needs of the States. Assignments, which are a fraction of the yield of certain specified sources of revenue, or bear a certain proportion to the total expenditure of the States, also give rise to difficulties of their own, as the proportion adopted must be more or less arbitrary ; and may, in the case of grants based on expenditure, as in South Africa before 1925, become the cause of an unnecessary increase of expenditure. Subsidies can be made for particular services ; and either their entire expenditure can be met out of the grants, or only a part of it. When a part of the expenditure is met in this way, the basis of the grants is generally the amount which is spent by the States themselves on the service, while if the whole is found, and the amount does not depend upon the service conforming to certain prescribed conditions or regulations, a *per capita* basis is again adopted. Subventions vary either according to the amount spent on the service, for which they are made, by the States, the most common standard being half and half, or according to the progress made in particular directions to which special importance is attached. In such cases, of course, the plan according to which the service is to be administered by the States is laid down for them ; and the continuance of the grants depends upon their submitting to supervision and inspection, and working up to and maintaining a particular level of efficiency. It is clear that there is nothing like a science of assignments, subsidies and subventions ; and the art of making them is conditioned by factors to which it is not possible to attach correct weights in their evaluation. Each country has to select its own bases for these contributions ; and though any rigorous tests of equity cannot be satisfied, it is possible, if sufficient care is taken, to adopt criteria which may, generally speaking, afford a fair basis for making these payments.

The general trend of our discussion of the problem of financial re-adjustment must have, by this time, made it clear that in India we have to provide for two kinds of payments from Central revenues to the Provinces. There

must, in the first place, be special assignments to those Provinces whose revenues are low and inelastic, and which are in a very backward condition on account of their low standard of expenditure; and, then, there ought to be payments from Central revenues on a basis which may be the same in the case of all Provinces. These can either take the form of assignments or subsidies; and as neither will involve increased control of the Provincial Governments by the Government of India, the bulk of payments to the Provinces must be made in these two ways. Subventions are dealt with in a subsequent paragraph. They ought not to be ruled out altogether; but, for some years to come, they will occupy a subordinate place in our system of federal finance.

Special assignments to the Provinces, which are in great straits, may first be considered. There is ample justification for these in the facts of the history of Provincial finance, which have been set forth in such detail already, and also in the vital necessity of bringing all parts of the country to an approximately uniform level of development. It is no use burking the issue. That has been done too long; and it has now to be faced. Taking the amount, which will be available for allotment among the Provinces, as Rs. 35 crores for the purpose of our argument, the earmarking of Rs. 8·5 crores for initiating a process of levelling up need not be regarded as an excessive provision for the purpose. The account of the relative position of the different Provinces, given in Chapter IV, may, in a general way, be taken as a conspectus of their finances; and the figures of the corresponding Tables[1] show, again very roughly, the extent to which measures of special assistance are necessary. It is not possible, merely on the basis of such data, to draw up a scheme of special assignments; and an exhaustive enquiry into the relative position of the various Provinces is necessary before a satisfactory scheme can be elaborated. It will be necessary to appoint a committee to assess the needs and

[1] Tables XXV, XXVI, XXVII and Tables XXVIII to XXXVI.

revenues of the Provinces, and to suggest the standard according to which the assignments should be made. It may be necessary, if it is possible, to frame a formula designed to measure the needs and the ability to pay of the different Provinces, according to which the assignments may be automatically made. Such a formula has been framed for the distribution of grants to the local bodies in Great Britain under the new De-rating Scheme. It is highly complicated; but, according to Mr. Neville Chamberlain, the late Minister of Health, it has been found from the results, which the formula produces, that it puts the money where it is meant to go, i.e. to the counties whose needs are the greatest.[1] The formula is based on population, which is taken as a measure of needs in the first instance. But as that in itself is an inadequate measure, population is 'weighted' by the rateable value per head, by the number of children under five years of age per 1,000 of the population (and this on the assumption that children increase as one goes down in the social scale), and, in some cases, by abnormal unemployment and sparsity of population. In India, the basis of the formula and its weights will have to be adopted in the light of local circumstances; for conditions here are entirely different, and the weighting of the basic factor by considerations such as the number of children per 1,000 of the population will not do, for on account of the excessively high rate of infant mortality among the poorest classes, the process of the nation dying on the top has not commenced here as yet. The rate of mortality, and particularly among children below the age of five, may well prove to be one fairly reliable guide to the relative wealth or poverty of a Province. The whole question will have to be carefully examined, and an attempt made to work out an empirical formula which may then be automatically applied for making special assignments. The formula may be complicated; but if it serves the purpose for which it is designed, and makes it possible for the Provinces, whose needs are the

[1] Neville Chamberlain, 'Local Government', *Nineteenth Century and After*, vol. CV, No. 623, January 1929, p. 7.

most urgent, to receive the largest grants out of the money set apart for redressing inequalities, the lack of simplicity need not be considered a serious or damaging defect.

But it is not at all certain that an attempt to find a self-acting formula for making special assignments, even if we are prepared to do without mathematical accuracy which, of course, cannot be attained, will succeed. It is not easy to find a rod for measuring the magnitude and the urgency of Provincial needs ; and even our committee of experts may have to report that such a formula cannot be found. It will, in that case, be necessary to fall back upon general considerations, argue the question on its merits, and make the assignments on a presumptive basis. The total amount of Rs. 8·5 crores will have to be assigned to the Provinces according to a scale, for which it may be possible to claim that it will establish a rough adjustment between the needs of particular Provinces and the amounts assigned to them. It is clear that the Province, which will have a first lien on our special assignments grant, will be Bihar and Orissa ; and if the figures given in the tables[1] are to be taken as some measure of its needs, the amount, which it should receive, should be a fairly large portion of the total grant. In Bihar and Orissa the incidence of taxation per head is, at the same time, low ; [2] and it must make earnest efforts to raise it to a higher level.

[1] Tables XXIII, XXIV, XXIV (*a*), XXV, XXV (*a*), XXVI, XXVI (*a*), XXVII, XXVII (*a*), XXXI.

[2] The two most important sources of revenue in Bihar and Orissa are land revenue and excise ; and about three-fourths of its tax-revenue is derived from these taxes. The comparative incidence per head is as follows :—

| | Land Revenue | | Excise (1926–27) |
|---|---|---|---|
| | RS. A. P. | | RS. A. P. |
| Madras | 1-11-6 | (1923-24) | 1-3-4 |
| Bombay | 2-10-1 | (1925-26) | 2-1-10 |
| Bengal | 0-10-2 | (1922-23) | 0-7-9 |

The continuance of the initial special assignment of this Province or its increase must be conditioned by its satisfying the National Finance Commission, whose appointment is suggested in the last chapter, that it has done and is doing its very best to help itself. This is a crucial consideration, and will have a very important bearing on the working of the whole scheme of special assignments. But taking it for granted that Bihar and Orissa is prepared to develop its own fiscal resources more fully, it will be entitled to receive liberal help from the national exchequer. The amount which may be considered due to Bihar and Orissa (taking the total allotment for annual special assignments as Rs. 8·5 crores) ought not to be less than Rs. 3 crores per year. This amount, and whatever general assignment it may receive, will not enable it to come up to the level of the more advanced Provinces, for the accumulated inequalities of years cannot vanish at once. All the same, the special assignment will enable it to raise its level of expenditure far above the present level, and to look forward to the future with hope and confidence that it need not mark time while the other Provinces and the country as a whole are going ahead. Bihar and Orissa has very cheering economic prospects. It can be predicted, in general

| | Land Revenue | | Excise (1926–27) |
|---|---|---|---|
| | RS. A. P. | | RS. A. P. |
| United Provinces............. | 1- 9 -5 | (1926-27) | 0- 4 -7 |
| The Punjab.................... | 2- 8 -5 | Do. | 0- 9 -7 |
| Burma.......................... | 4-15- 8 | Do. | 1- 0 -1 |
| *Bihar and Orissa............* | *1-7 -0* | Do. | *0- 9 -3* |
| Central Provinces........... | 1- 9 -9 | Do. | 0-15-7 |
| Assam.......................... | 1- 7 -10 | Do. | 0-15-2 |

It must be admitted that low incidence of taxation is, to no small extent, responsible for the low level of development of Bihar and Orissa; and the Province cannot vindicate its claim to special assistance without taking effective measures to raise its taxation to a higher level. An inheritance tax, a tax on the capital value of land and a tobacco duty will, if properly developed, enable it to realize this object in a very large measure.

terms, that there is practically a certainty of Chota Nagpur developing into a most important industrial area; and it has to be provided with funds which may be adequate for its present requirements and future developments. A special assignment of Rs. 3 crores will, therefore, be a substantial measure of assistance, though, as already remarked, it will not place at its disposal resources large enough to remove entirely the inadequacy of its financial resources. Next to Bihar and Orissa, the Province which needs special assistance most urgently is, of course, Bengal. The level of taxation is also very low in this Province; and it will have to tap its own resources to a much larger extent than it is doing at present. Assuming, however, once more that it also will be able to satisfy the National Finance Commission that it is taking every possible step for adding to its own resources, an annual grant of, say, Rs. 1·75 crores out of the special assignments fund will not be in excess of its immediate needs, and may, if we take into account its vast population, insanitary climate and other handicaps, be considered inadequate by the people of that Province. But as we cannot set up an exacting standard of equity, if we are to depend upon general considerations for making these assignments, this amount will probably do as a very rough measure of the needs of Bengal. Next to Bihar and Orissa and Bengal, the United Provinces standard of expenditure is and has for long been the lowest in India;[1] but the relief which it has received on account of the remission of its contribution to the Government of India, and the prospect of its receiving a large amount as its share in the scheme of general grants if they are, as suggested below, made on the basis of population, render it unnecessary to give it a large special assignment. A block grant of one crore ought to do for its needs, taking into account, of course, the fact that every Province and the country as a whole, have to be content with what is practicable for the time being and to continue to make unremitting efforts to

[1] Tables XVII, XXVII (*a*) and the Tables of 1876-77 and subsequent years.

expand the public revenues. The Central Provinces and Assam[1] are, taking an all-India view, nearly in the same position, though as between themselves the Central Provinces is slightly better off. The population of the Central Provinces is larger than that of Assam, and its general assignment will be correspondingly greater. A special assignment of one crore to each of them will probably be fair as between themselves, and also from the point of view of the country as a whole. Their general grants are likely to be small; and as they are backward Provinces, special assignments equal to that which the United Provinces will get will not, even relatively speaking, be excessive for them. As Burma is wholly *sui generis* for the purpose of financial re-adjustments, there are three Provinces left whose cases have to be considered. They are Madras, the Punjab and Bombay. It will generally be admitted that the first two do not stand in need of special assignments. Their financial condition, indeed, is buoyant, comparatively speaking. Madras will receive a large general grant; its standard of expenditure, leaving aside Bombay and the Punjab, compares favourably with that of other Provinces; [2] and the addition of Rs. 3·48 crores to its resources on account of the remission of the Provincial contributions makes it unnecessary to devise any special measure of assistance for Madras. The Punjab has also received Rs. 1·75 crores by the abolition of Provincial contributions; its standard of expenditure is high, and has risen since the introduction of the Reforms at a rate [3] which may well turn, if a colloquial phrase is permitted, the other Provinces green with jealousy; and its revenue, as remarked in Chapter IV, will retain its expansive character. It can afford to adopt an attitude of benevolent indifference towards the less fortunate Provinces, and let them receive special assistance from Central revenues without claiming any share in the favours going. The case of Bombay is very peculiar. Its standard of expenditure and revenue per

[1] Tables XXV, XXVII, XXVII(*a*), XXXIV and XXXVI.
[2] Tables XXVII, XXVII(*a*).
[3] Table XXXII.

head have been and are so high, and it will take most of the other Provinces[1] so long to make even an approach thereto that it is difficult to sustain the claim which is so often put forward on its behalf that it has a right to be provided with funds to maintain the standard which it has been allowed to establish in the past, and have a liberal margin for expansion into the bargain Now no one suggests that because an exceptionally high standard has been set up in Bombay, we should try to reduce it to the all-India average. That is both unfair and impracticable. But it is not possible for Bombay to ask for special treatment on account of its having been a favoured Province in the past. Those who hold a brief for Bombay cannot compare the percentages of the growth of expenditure in different services in other Provinces with the corresponding percentages in this Province, and ask for consideration for Bombay's financial difficulties on the strength of that comparison. If Bombay's expenditure is to grow at the same rate as that of other Provinces, it means that its income will have to expand more than twice as fast as theirs—a proposition to which even the most extravagant advocates of Bombay's claims would scarcely subscribe. Bombay, as compared with the other Provinces, has been progressing so rapidly in the past that it has to realize the necessity of slackening its pace. It must be content to go slower than the other Provinces, and permit the distance that separates it from them to diminish in the future. If it is not prepared to accept this result with good grace as a part of its national duty, it must do so owing to the sheer necessity of the circumstances. On the other hand, it is too much to expect that Bombay should stand still while the other Provinces are marching on. Movement is a necessary condition of the health and efficiency of the organs of national life, and as each Province has to function as such an organ, it is necessary that Bombay also should have larger resources. It will, of course, get its general grant; but that, comparatively speaking, will not be large, and as the level

[1] Tables XXV and XXVII and XXVII(*a*).

of taxation is already high in Bombay, it will be necessary to give it a special assignment to make it possible for it to stave off the prospect of complete stagnation. The amount cannot be large owing to the pressing needs of other Provinces ; but if it gets Rs. 75 lacs as a special assignment, this, together with a general grant and the amounts which it will be able to raise by other measures of taxation, ought to give it scope for development, which will not be less than what it has a right to expect under the existing conditions.

As the special disadvantages, which necessitate the grant of special assignments, will continue to affect the financial position of the Provinces concerned for some years to come, it is necessary to make provision for their increase in order that the measures of improvement, which may be undertaken, should not become less effective later on on account of the growing burden of the charges, which their further development will necessarily bring in its train. The increase of these special assignments will, of course, depend upon the Government of India being able to realize a permanent and recurrent surplus ; but as the latter ought to shape its financial policy so as to ensure the accrual of the amount required for meeting this additional liability, a scale ought to be laid down according to which the increase in the total amount of special assignments might be regulated. If a formula for the payment of these grants can be found, and brough into operation, this increase should be governed by its provisions ; but, otherwise, the additions to special assignments should be determined by the same considerations by which the initial assignments are fixed and should, of course, bear a definite relation to them. As the initial assignments referred to above have been suggested merely by way of illustration, the scale according to which they ought to increase may also be sketched with the same purpose. The total amount may be increased from Rs. 8·5 crores to a little over Rs. 13 crores in five years, and worked up to according to the following scale.

(In lacs of rupees)

| | Initial assignment | 1st year | 2nd year | 3rd year | 4th year | 5th year | Total |
|---|---|---|---|---|---|---|---|
| Bihar and Orissa. | 300 | 33 | 33 | 33 | 33 | 18 | 450 |
| Bengal ... | 175 | 20 | 20 | 20 | 20 | 10 | 265 |
| United Provinces. | 100 | 12 | 12 | 12 | 12 | 6 | 154 |
| Central Provinces. | 100 | 12 | 12 | 12 | 12 | 6 | 154 |
| Assam ... | 100 | 12 | 12 | 12 | 12 | 6 | 154 |
| Bombay ... | 75 | 11 | 11 | 11 | 11 | 6 | 125 |
| Total ... | 850 | 100 | 100 | 100 | 100 | 52 | 1302 |

The increase of these special assignments, and the continuance of the assignments themselves not only in the case of Bihar and Orissa and Bengal, but also of the other Provinces should depend upon their giving full satisfaction to the National Finance Commission regarding the development of the Provincial taxes. These grants should not only be regarded as a means of quickening the pace of progress in backward Provinces, but also an incentive for bringing about the fullest development of our tax-system without any unnecessary delay. The Government of India should help not only those Provinces whose needs are the greatest, but also those which are prepared to help themselves. It will be one of the most important duties of the National Finance Commission to keep a watch over the tax-system of the country as a whole, and make sure that its development in all parts of the country is even and well-balanced. Our system of federal finance must not, as has been emphasized already, weaken the motives for self-help and self-reliance. Each Province should receive according to its needs, but not till it can

satisfy itself and the nation that it is giving according to its capacity. The aim is to embody all that is best in the joint family system without entailing the drawbacks which are commonly associated with it. Here it is necessary to state specifically, though it has been implied all through the foregoing paragraphs, that these special assignments should be given to the Provinces without attaching any conditions to their payment, except the one referred to above ; and they should be free to spend them according to their needs and the judgment of their Governments, subject, of course, to the sanction of the Provincial legislatures. They are assignments in the sense in which the word is being used in these pages, and the fact that they are special grants does not change their essential character.

Though the question of special assignments may be taken as settled for the purpose of this book, the bigger and more difficult question of general grants to the Provinces has still to be considered. How are they to be distributed ? Of the different bases which can be adopted for these grants, the basis of population is the one most generally used, on account of the ease with which the grants can be administered if their amount can be determined by the mere counting of heads. The popularity of this method as a means of settling all important issues of politics is due to its being the basis of modern democracies. It is supposed to ensure that every one counts, and that no one counts for more than any other. In the working of political institutions this assumption, as is well known, is based on the political myth that it is the best method of ascertaining and registering the common will, and more often than not, it is a method which fails grievously in actual practice. In finance, the population basis is generally equally unsatisfactory, for it is neither an accurate index of needs nor of resources. This objection is serious, for the method at times works in such a perverse manner as to give rise to all kinds of anomalies. In India, however, in the present circumstances, the method can be used for satisfying what is perhaps the most paramount need of our national life, and one which can be measured

fairly well by the democratic device of 'weighting' according to numbers. It is necessary to say a few words about this need itself before explaining its financial aspect.

'Few people will be found to deny that lack of education, specially among the masses, is one of the main roots of India's ills,—social, economic and political,—and her comparative backwardness in so many spheres of human activity is traceable to this one ultimate cause. On the eradication of this defect depends alike the economic uplift of the people, and the full and intelligent realization of the ideals of nationhood and self-government so long and fervently cherished by her political leaders.'[1] This extract from a well-known official publication is as good a summary of the situation, with regard to education, as it is possible to have in a few words. The amount of ignorance in India, as every one knows, is appalling; and in spite of the rapid progress made in recent years, the position is that in 1927, out of a population of 247 millions in British India, the number of literates was only 18·6 millions. The percentage of literacy among the total population of 20 years of age and over was 21 (the percentage among females being only 1·9); out of 18½ millions of boys of primary school age in 1925–26 the number of pupils in primary schools was 6·88 millions; out of 18 millions of girls of the same age there were 1·75 million pupils in primary schools; the total expenditure on education from all sources was Rs. 24·58 crores in 1926–27 and on primary education Rs. 6·95 crores Finally. the movement towards adult education has hardly commenced, the total expenditure on it in 1927 amounted to but Rs. 1·28 lacs, the number of pupils to 98,000, and only one Province, viz. the Punjab, has really made any progress in this direction. It is not necessary to give the figures for previous years, and indicate the extent to which the situation now is a great deal better than before. What matters is not what has been done, but what remains to be done for the education of our people. Poor as is the quantity of our

[1] *India in 1927–28*, p. 362.

education, its quality is poorer still. The amount of waste in our educational system is so great that we are not getting at all good value for the money that we are spending upon running it. The Agricultural Commission has drawn pointed attention to the wastage that is taking place in our primary schools on account of the boys, and even more the girls, leaving school before literacy has been firmly attained.[1] The inefficiency of our secondary schools, and even of our colleges, is a matter of common knowledge; and the village schoolmaster, to quote from *India in 1927–28* once more, 'is too feeble a ray to dispel the surrounding gloom of ignorance unaided'. We need, not only more education, but better education, much better than we are getting now.

All this is well known. What we need is immediate action, and that on a large scale. We cannot afford to listen to the counsel of hastening slowly. In 1911 Mr. Gokhale initiated the movement in favour of compulsory education. To-day, in spite of the enactment of the Primary Education Laws, which have provided for compulsion by the local bodies in almost all Provinces since the introduction of the Reforms, the latest available figures show that only in 114 municipalities and 1,527 rural areas has compulsion been actually introduced; and of these the Punjab contains half of the municipalities and all but 28 of the rural areas. This will not do. The Agricultural Commission are of opinion that the enormous wastage, which is taking place in the primary stage, cannot be stopped without compulsion; and still they think that the introduction of compulsion in the rural areas is not only a question of years but of decades. The imperative necessity of raising the cloud of depression which hangs so heavily over our entire national life, of changing the whole outlook of the masses, of breaking the 'bond of iron tradition and age-long custom', of mobilizing all the latent energy and enterprise of the people for economic progress, and of educating our masses owing to the impending advent of democracy make it essential for us to plan and carry

[1] *The Report of the Royal Agricultural Commission*, pp. 521–22.

out a scheme of mass education with the utmost expedition and despatch. We cannot wait for decades; we must have a scheme in full operation in a few years, and make it yield quick and good results. However ambitious and even chimerical it may sound, we must realize the need of the hour, which is that we must take the work of the enlightenment of our people immediately in hand, and strain every fibre of our being to complete it as soon as we can. The Russians have achieved marvellous results in banishing ignorance and illiteracy in one decade; and it is not necessary to subscribe to their creed in order to command the courage and the faith necessary for undertaking a similar programme. It is not enough to provide for children between five and ten, we must also carry through a programme of adult education; otherwise, we shall have to wait for a generation in order to realize the advantages of literacy in the different spheres of our national life. We must, of course, take special measures for pushing on the education of girls and women; for that is the surest and most efficacious way of educating the nation. The difficulties in the way of making a rapid advance in all these directions are not all financial. We have to reckon with our atrophied social institutions, the influence of a 'tradition that has lost its soul', the false ideals in education, and the apathy of our people. We shall have to make a frontal attack on these bulwarks of darkness and inertia, if we want to make any progress; but the essential condition of our success is that we should have a good stock of 'silver bullets' for our crusade against these internal enemies of our national freedom. In plain language, we should devote all the money that we can get to developing primary and adult education. This duty should be at once attended to, and performed by the nation as a whole. Everyone will agree that all the Provinces have an equal interest in the question of compulsory elementary and adult education; and it will not mean any derogation of their authority and status, if they are granted subsidies by the Government of India for education in the territories under their jurisdiction. There is no other object which can be

said to have a prior claim in any Province over our resources; and the Provinces in co-operating to carry out this national programme will not only be rendering a national service, but also fulfilling a primary obligation of their own. Subsidies from the Central revenues to the Provinces, unlike the Provincial contributions, will be twice blessed—they will bless the Government of India and the Provincial Governments alike—and need not give rise to anything discordant or anything but the consciousness that all are participating in fulfilling a duty, the discharge of which is the one thing which is absolutely necessary for 'the full and intelligent realization of the ideals of nationhood and self-government, so long and fervently cherished by India's political leaders'.

Such a scheme of primary and adult education will be very costly; and it is very difficult to estimate the amount which will be required for its execution. According to one estimate, as already stated, we shall need Rs. 60 crores for compulsory primary education alone. Now we are spending about Rs. 7 crores for 8·58 million pupils, i.e. about Rs. 8-4-0 per head. There are more than 27 millions of children of primary school age, who have still to be provided for; and even at this rate we shall need over Rs. 20 crores for recurring expenses. But the standard of expenditure on primary education has to be raised. The increase in the number of pupils will lead to some economies. It has been said that the full economies of administration cannot be realized unless the number of pupils per school is 100; and the present average is 43. But even so it will be necessary to increase the expenditure per pupil on account of the admitted need of improving the quality of the teacher. Everything depends upon him; and as the standard of culture and life, which he can maintain with the miserable pittance which he gets at present, can neither be calculated to inspire confidence in others nor preserve his own self-respect, he will have to be much better paid, if he is to do one-fourth of all that is generally expected of him. Compulsory primary education is, therefore, going to be a costly undertaking; and if we are to introduce

schemes of adult education also, we shall have to provide larger funds than we can expect to raise for some years. Still a determined and a big effort has to be made to forge ahead; and if we can spend about Rs. 25 crores for this national enterprise at the outset, it will not be a bad beginning. The Provinces should receive this amount from the Government of India, and devote it to the cause of primary and adult education.

A *per capita* grant for this purpose to all the Provinces will not be inequitable, as the population basis is a fairly satisfactory measure of the amount which will have to be spent by each Province for increasing the facilities of mass education. Though the percentage of scholars at the primary stage to the total population of school-going age, and that of literacy among the total population of twenty years or more, vary from Province to Province, yet the uncovered field in every Province is so vast that it will be fair, as well as necessary, to make grants for education on a population basis. In the beginning, it will not be possible to give more than Re. 1 per head. If this rate is adopted, the different Provinces will receive approximately the following amounts :—

*In lacs of Rupees.*

| | | |
|---|---|---|
| Bengal—467 | Punjab—206 | Burma—132 |
| United Provinces—454 | Bombay—194 | Assam—76 |
| Madras—423 | Central Provinces—140 | |
| Bihar and Orissa—340 | | |
| | | Total 2,432 |

It will be seen that, according to this basis, the four Provinces which receive the largest amounts are, with the exception of Madras, just those Provinces whose general standard of expenditure, including expenditure on education, are the lowest.[1] As Madras does not get any special assignment under this scheme, a large general grant will

[1] Tables XXVII and XXVII(*a*).

not unduly increase its resources, though it will, relatively speaking, be quite adequate for its requirements. From the point of the view of the nation, each Province will be placed in funds to perform a national duty and a primary obligation, and amongst the Provinces themselves payment of grants on this basis will produce results which will not involve injustice to any one of them.

The question as to whether these grants will in any way impair Provincial autonomy has still to be answered. The negative answer has already been suggested, but it needs to be explicitly stated. These grants will be subsidies in the sense in which the term has been defined. They will be made for a specific purpose, and, of course, spent accordingly. It will be for the audit officer to see that such subsidies are used only for the purpose for which they are granted, and that their expenditure is governed by the canons of financial propriety which will be applicable to all expenditure, Central and Provincial. Otherwise the Provincial Governments will not be a whit less autonomous than if they never received these grants, and their administrative control over the services, on which they are spent, will not be in any way decreased. In order to avoid waste and to frame an all-India policy, it will probably be desirable to appoint a National Commission on Primary and Adult Education. This, with the help of Provincial Committees, will survey the whole field, collect the relevant data, and prepare a scheme for the general guidance of the Provincial Governments and their Legislatures, which ought to be comprehensive enough to embody the principles of a national policy and also to contain proposals suited to the local conditions of particular Provinces. The scheme of the Commission will, if it is properly constituted and imbued with the right spirit, have great weight with the Provinces, and will, in all essentials, be put into effect by them ; but that will be due to its intrinsic merits, and not to any 'sanctions' behind it. It will also be necessary to create an Inter-Provincial Board, which will be a standing body for the purpose of co-ordination and on which all the Provinces will be duly represented. This Board will be a clearing

house of ideas, a means of pooling the experience of the different Provinces and enabling their representatives to appreciate all-India aspects of the policies which they will have to administer. The organization of the all-India body will probably be divided into two parts, a General Council, and an Advisory Board consisting of experts, whose function it will be to compile and collate information relating to all the Provinces, and to acquire a first-hand knowledge of the conditions of administration by occasional visits to the different Provinces. Its only means of impressing the national standpoint on the Provinces will be to advise the General Council to suggest to them certain measures and policies, which again will receive the earnest consideration of the Provinces but will not be in any way binding on them. The Inter-Provincial Board will only prepare, to use words which find such a conspicuous place in the reports of the proceedings of the League of Nations Committees and Conferences, draft conventions which will afterwards have to be 'ratified' by the Provincial Legislatures. The occasions on which the latter will not 'ratify' them will, of course, be very rare; but the voluntary character of these common policies will always be preserved. In brief, the Provinces will spend these grants on primary and adult education, according to a national plan, which will be evolved and carried out in such a manner as to provide scope for the greatest amount of inter-Provincial co-operation, but will not involve control of the Provincial Governments by the Government of India.

Special assignments and subsidies will, between them, almost exhaust the surplus resources of the Government of India; and very little will be left for grants-in-aid or subventions. If we take Rs. 35 crores as the amount available for payments to the Provinces, the special assignments and subsidies will, if the above plan is carried out, cost Rs. 33·82 crores; and only Rs. 2·18 crores will be available for subventions. For some years to come, therefore, subventions will not be an important feature of the fiscal relations of the Government of India with the Provinces. This will not be altogether unfortunate, because it will give the latter time to

stabilize their finances, as well as reassuring them that their financial autonomy is not put in jeopardy by the system of assignments and subsidies. But even so there is no reason why the Government of India should be precluded altogether from making grants for specific purposes, for objects of national importance, and prescribing conditions for their expenditure. Such grants are now, as already stated, practically unconstitutional; but it would be a mistake to make a similar provision in the new constitution. The Agricultural Commission and the Road Committee have both pointed out the advisability of removing this ban on the expenditure from Central revenues on Provincial subjects in the interest of the development of agricultural research and of the road system of the country. They are both subjects possessing national significance; and particularly 'road development here, as elsewhere, is now,' as the Road Committee have stated, 'passing beyond the financial capacity of local Governments and local bodies, and is becoming a national interest which may, to some extent, be a charge on Central revenues.'[1] Our arterial routes must be developed according to a national plan; and 'it is', to quote from the Road Committee Report once more, 'difficult to foresee, and difficult to exaggerate, the effect on the life of the nation of this annihilation of distance and of the consequent awakening of the rural population.'[2] The road system must now be a national concern; and it is necessary to ensure that its development will proceed on national lines. In this case, co-ordination will have an element of control in it; and grants from Central revenues will only be made for approved projects and approved expenditure. There are other matters, with regard to which it is necessary to stimulate Provincial enterprise, and synchronize the pace of development. The Government of India should, in such cases, be in a position to safeguard the national interest, to ensure that co-ordination among the different Provinces and even the Indian

[2] *The Indian Road Development Committee Report*, p. 32, para. 57.

[1] Ibid., p. 19, para. 34.

States will be complete, and to lay down a standard of efficiency below which the administration of such services should not be allowed to fall. The best method of administering the funds set apart for such purposes is to create separate funds for the subjects, with regard to which co-ordination is deemed essential, which would be under the control of Central Boards. Such Boards will occupy a fiduciary position in the administration of the country, and administer these funds as trustees. Their constitution will be akin to that of the newly created Agricultural Research Council; and the Provinces and other interests affected by these grants will be fully represented on them. The Road Committee has rejected the proposal for constituting a Central Road Board, mainly on the ground that it would trench upon a sphere which ought to be under the exclusive control of the Central Legislature. This view is based on a misconception of the nature of the subjects for which co-ordination will be necessary, and does not take into account the need of associating the representatives of the Provinces in the administration of these funds. The subjects, which will require concerted action, will be of a highly technical character, and will approximate to the socialized undertakings, with regard to which 'neither committee control through Parliament,' as Mr. G. D. H. Cole has pointed out in his latest book, 'nor purely departmental control, subject to occasional Parliamentary interference, will meet the need'.[1] The administration of these subjects, to quote Mr. Cole's words again, 'whatever qualities of personality and political wisdom it may demand besides, is essentially an affair of the experts'.[2] The Central Legislature should, of course, have the right of laying down the general policy, and also to hold in reserve the authority to interfere if the funds are mismanaged; but their actual administration should be entrusted to *ad hoc* bodies, specially created for the purpose. On these Boards, non-experts should also be

[2] G D. H. Cole, *The Next Ten Years in British Social and Economic Policy*, p. 135.
[3] Ibid., p. 136.

represented; but these are not matters for amateurish handling, and ought to be in the hands of those whose competence to deal with them is beyond question. It is also desirable to let the Provinces feel that they are partners in the execution of national policies and in the administration of grants for national undertakings and this end cannot be attained, if the grants are to be under the control of Departments of the Government of India. This is the form in which the new conception of the social control of services of vital importance is likely to embody itself in all countries; and India, in adopting it, will not only be devising a machinery suited to her own needs, but also coming into line with the development of social policies all over the world. These grants, as a rule, will be apportioned among the Provinces according to a fixed formula; but it will, as in the case of the Road Fund, be necessary to have a reserve for ' special grants, where for some reasons there is need for special aid '. Such reasons will always exist; and it will not be possible to regulate Central expenditure on these subjects merely by rule of thumb. These subventions will thus be granted for purposes in which co-ordination is essential in the interests of India as a whole, and will be so administered as to minimize the possibility of their being used merely as instruments of centralization. The Provincial Governments will have to submit to a certain measure of Central control; but it will be self-imposed in a very large measure, and there will be nothing arbitrary or haphazard about it. The amount of the subventions, compared to the payments made in the other two forms, will not be large; but an amount of over Rs. 2 crores ought to be available for the purpose, and will be a fairly good nucleus of the funds reserved for ' rationalizing ' the administration of subjects, whose scope and importance transcend Provincial boundaries.

Burma (to come again to Provinces) will, under the above plan, get the education grant of Rs. 132 lacs, and will be at liberty to increase its own resources by additional taxation. The standard of expenditure in Burma compares very well with that of other Provinces; and

judged by the Indian standard, its resources are adequate for its needs. As already remarked, however, from the point of view of financial re-adjustment, the case of Burma is very peculiar; and it is difficult to devise a scheme which will be satisfactory both for Burma and India as a whole. The Road Committee have recommended that schemes of road development in Burma should not need the approval of the Governor-General in Council, as 'road development there', according to the Road Committee, 'is a self-contained problem, and has no all-India aspects'. The same consideration applies to so many other problems; and though it cannot be said that the problem of financial re-adjustment with Burma has no all-India aspect, it is not possible to settle it as a part of an all-India plan, and Burma has a very good case for a separate financial settlement. The whole position is very obscure just now; and if Burma is to remain a constituent unit of an all-India federation, it will do so on special terms, for the ties which bind it to India are not very close, and time is not likely to make them any closer than they are to-day. There is, therefore, a case for a special enquiry and a separate settlement.

The position of other Provinces under this scheme may, however, be briefly summarized. They will continue to administer and appropriate the yield of the sources of revenue which are now Provincial, though with regard to some of them Central regulation will be necessary. These sources are: land revenue, excise, stamps, registration, irrigation, forests and departmental receipts. They will also assess and collect the tobacco duty on vend and the tax on the capital value of land, and will use their receipts for their own purposes; while the death duties will be administered by the Central authorities, and their yield allotted to the Provinces according to an accepted convention. The Government of India will administer customs, income-tax, salt and revenue excises; but by revising the rates of these taxes, introducing some new ones and practising certain measures of economy, will aim at realizing a substantial surplus, which, for the purpose of the argument of this book, has been assumed to be

Rs. 35 crores. The whole of this amount will be apportioned among the Provinces in the form of special assignments, subsidies and subventions. Special assignments will be determined by the needs of the Provinces; and some of them which, on account of historical causes and special circumstances, are in grave financial straits, will get larger amounts than others, while Madras and the Punjab will not get any special assignments owing to their having increased their resources considerably under the existing settlement. The initial special assignments will amount to Rs. 8·5 crores, and will be increased to Rs. 13 crores in five years. The additional assignments will be given on the same basis as the initial assignments; but the payment of special assignments, both initial and additional, will depend upon each Province fully developing its own fiscal resources. The proposed subsidies will be paid for elementary and adult education, and on a population basis. There will be provision for evolving a national policy of mass education without involving control of the Provincial Governments by the Central Government. These grants will amount to Rs. 24·32 crores. Special assignments and subsidies will, otherwise, be applied by the Provinces as may seem good to each, and will not be used to circumscribe their financial powers. Subventions will be made for specific purposes and subject to certain conditions; but generally they will be credited to special accounts, and administered by *ad hoc* bodies of trustees. On these bodies, the Provinces and other interests will be fully represented. The amount available for subventions will be Rs. 2·18 crores, and will, comparatively speaking, remain small for years to come.

In order to get a concrete idea of the effect of the scheme on the relative position of the Provinces other than Burma, their resources in 1928–29, in 1931 (assuming it to be the first year of the introduction of the scheme), and in 1936 may be set forth in a tabular form.

Statement showing the financial position of the different Provinces in 1928–29, 1931–32 and 1936–37.

## I

*Revenue in lacs of Rupees*

| | 1928–29 | 1931–32 | 1936–37 |
|---|---|---|---|
| Bombay | 1,574 | 1,843 | 1,918 |
| Central Provinces | 554 | 794 | 848 |
| Madras | 1,697 | 2,120 | 2,120 |
| Punjab | 1,273 | 1,479 | 1,479 |
| United Provinces | 1,247 | 1,801 | 1,855 |
| Bengal | 1,093 | 1,735 | 1,825 |
| Assam | 278 | 454 | 508 |
| Bihar and Orissa | 578 | 1,218 | 1,368 |

## II

*Revenue per 1,000 of population*

| | 1928–29 | 1931–32 | 1936–37 |
|---|---|---|---|
| Bombay ... | 8,284 | 9,500 | 9,887 |
| Central Provinces ... | 4,262 | 5 672 | 6,057 |
| Madras .. | 4,040 | 5,012 | 5,012 |
| Punjab .. | 6,365 | 7,185 | 7,185 |
| United Provinces ... | 2,771 | 3,968 | 4,086 |
| Bengal ... | 2,376 | 3,716 | 3,951 |
| Assam ... | 3,971 | 5,975 | 6,687 |
| Bihar and Orissa ... | 1,688 | 3,582 | 4,024 |

III

*Index Number of Revenue per 1,000 of population supposing the revenue of Bihar and Orissa to be 100*

| — | 1928–29 | 1931–32 | 1936–37 |
|---|---|---|---|
| Bombay ... | 492 | 265 | 245 |
| Central Provinces ... | 253 | 154 | 150 |
| Madras ... | 239 | 140 | 125 |
| Punjab ... | 379 | 201 | 179 |
| United Provinces ... | 164 | 111 | 102 |
| Bengal ... | 145 | 104 | 98 |
| Assam ... | 235 | 162 | 166 |
| Bihar and Orissa ... | 100 | 100 | 100 |

This comparative view of the financial position of the different Provinces is based on certain arbitrary assumptions with regard to the normal growth of revenue and increase in resources by additional taxation, which cannot be expected to be completely realized in actual practice. The existing sources of revenue are expansive in varying degrees in the different Provinces, and the additional taxation contemplated will not bring the same quantity of grist to the Provincial mills, compared to the size of their population; but still it is clear that re-adjustment on the lines suggested above will remove the disparity in fiscal resources to an appreciable extent. The Provinces will not be placed on a position of absolute equality; but the inequalities will be greatly reduced, and more than that cannot be asked of any scheme of re-adjustment. Absolute equality among the Provinces will not only be unattainable in the near future, but is a conception which is very difficult of application in actual

practice. That the glaring inequalities should be redressed is, however, not a chimerical object and ought to be realized. In Provinces like Bihar and Orissa, Bengal and the United Provinces, the incidence of taxation is low; and they ought to be able to improve their position still further by adopting measures of additional taxation.

This scheme of re-distribution of revenues will accord with the general principles enunciated in the previous chapters. It will give to each authority the sources of revenue which it can efficiently administer, and will avoid the possibilities of conflict among different tax jurisdictions. It will be capable of early application, and will not involve any dislocation of the finances either of the Government of India or of the Provinces. There will be provision for the expansion of the resources of the Provinces, and, therefore, for the development of the vital services for which they are and will remain responsible. They will have their own fiscal sphere; and though the range within which they will be able to vary the rates of taxation will not be very wide, there will be plenty of room for Provincial enterprise in the development of fiscal resources, and they will have an incentive to help themselves by expanding their revenues. The Government of India will make large payments to the Provinces out of the revenues which they will be collecting, but they will not thereby increase their control over the Provincial Governments. Provincial autonomy will not be impaired in any way by the operation of the scheme. There will be definite provision for satisfying the need of removing financial inequalities, and the measures suggested for the purpose will be efficacious to a very considerable extent. The scheme will most likely take about five years to come into full operation, and ought to be given a fair trial. But nothing should be done to make it less flexible than it ought to be. It is necessary to be prepared for unexpected contingencies and new developments. This aspect of the matter will be further considered in the last chapter of the book.

## CHAPTER VIII

### *Financial Relations*

It was pointed out in the first chapter that the financial settlement should, if it is to be comprehensive, include matters other than the re-allocation of resources. These are important, and have to be carefully considered. Under the existing settlement, though there is a complete separation of the sources of revenue of the Central and Provincial Governments, in other matters the transactions of the Government of India and those of the Provinces are intermingled; and it is impossible at any point of time to distinguish Central transactions from Provincial. The administrative clean-cut does not extend to financial matters; and the Government of India are in charge of funds which, properly speaking, belong to the Provinces, and perform functions which are of very great interest and importance from the standpoint of the stability and solvency of Provincial finances. In theory, the revenues of India still constitute one consolidated fund; and the liabilities of the Provinces are the liabilities of the Government of India. Officers, under the administrative control of the Government of India, are performing what are purely executive duties for the Provinces; and some officers of the Provinces are, in their turn, under the dual control of the Provincial and Central authorities. These are matters which were, to a certain extent, slurred over by the authors of the Reforms; and it will now be necessary to devise arrangements consistent with the underlying principles of the new constitution. It has already been made clear that we ought not to strive to introduce a system under which the points of contact between the Government of India and the Provinces are deliberately made as few as possible, or allow ourselves to be dominated by old and worn-out traditions of federal constitutions. The division of powers should depend

upon the division of functions, and not the division of functions on the division of powers. If we are to combine the solidarity of the whole with the vitality of the parts, we should make use of theory to clarify our ideas, but not allow theory to control our thinking. The dangers of 'politicizing' our financial settlement, to use Dr. Hensel's word again, must be carefully provided against. The need of this safeguard is specially great with regard to the matters which are to be discussed in this chapter.

The first question which has to be considered pertains to the general relations of the Provinces with the Government of India in respect of taxation. The system of Indian taxation has to be viewed as a whole. It will not do to assign certain taxes to the Government of India and others to the Provinces, and give them an absolutely free hand with regard to the taxes which they can call their own. In the region of taxation, little importance is to be attached to mere names. The Taxation Enquiry Committee have pointed out how some of the recent developments of local taxation have brought certain factors into play which, if allowed to operate unchecked, will introduce very grave abuses in our system of taxation. There is no use, for example, in centralizing income-tax, if the local bodies can practically introduce their own income-tax under the names of trades and professions taxes and Haisiyat duties. The centralization of customs and of revenue excises is also of very little avail, if the municipalities can have their own consumption taxes, and even make use of them to discriminate between the goods of different countries or it may be even of different Provinces of India. What matters is not the names of the taxes, but their incidence and economic effects. The integrity of the tax system, as a whole, must be kept intact. Harmonization of taxation means not only that friction between the different taxing authorities should be prevented, but that the whole tax-system should, within the limits set by the necessity of giving them their own resources, be well-balanced ; and it should not be possible for any governing body to disturb its equilibrium by ill-considered action. This is essential for the ordered

development of the system of taxation as a whole. For the attainment of this end, two provisions are necessary. In the first place, the Government of India should have all residuary powers in the matter of taxation; i.e. no new taxes, which are not specifically assigned to the Provincial Governments or the authorities subordinate to them, should be imposed without the previous sanction of the Government of India. They should not be allowed to trench upon the fiscal sphere of the Central Government, or introduce measures which involve taxation of the residents of other Provinces. The principles and details of all new proposals of taxation should be examined from the national standpoint, and all possibilities of disharmony or conflict duly provided against. But it is not sufficient merely that all new taxes should be sanctioned by the central authorities. Even with regard to those taxes, which may be Provincial or local, it is necessary to safeguard the unity of the tax-system, and make it possible to prevent developments which might be undesirable from the point of view of the country as a whole, or come in the way of the due discharge of certain of the functions of the Central Government. The Government of India are committed to certain international obligations. Some have been imposed upon them on account of Great Britain being a party to commercial treaties, certain provisions of which are applicable to India. In future, it may be hoped that India will only be a party to those treaties, which have received the approval of the Central Legislature. Still it is wrong, in principle, that local authorities should be in a position to adopt measures which may have wide repercussions, and the Government of India not have any cognizance of the matter. The Bombay Corporation is levying a town duty on cotton which is, to all intents and purposes, an export duty; and it is possible that other cities may like to follow its example, and tax staple exports under different names. The Provinces and local bodies should not be allowed to introduce taxes, in disguised forms, which have important all-India aspects, or otherwise upset the balance of the tax-system by using their taxing powers in an indiscriminate manner. All inter-Provincial

disputes will, of course, be adjudicated upon by a central body; and procedure must be prescribed, according to which they will automatically come up for its consideration. In the region of taxation, co-ordination is a vital necessity of national life, and should be completely ensured.

The National Finance Commission, referred to in the preceding chapter, will be the organ through which the integrity of our tax-system will be preserved. The Commission should be placed in a position to keep a watch on the working of the tax-system as a whole, should be kept fully informed of all its important developments, and have the power to prevent the adoption of any measures, which may be expected to have undesirable reactions on the fiscal inter-relations of the Government of India and the Provincial Governments. Under the Reforms, the Government of India, in spite of their wide powers, have been unable to exercise this regulative authority with regard to the scheduled taxes; and the local bodies have had a free hand in dealing with matters, which ought to have been outside the purview of their authority. It was suggested in the Joint Report that, even when a tax fell within a schedule, the Bill should be forwarded to the Government of India to enable them to satisfy themselves that the proposal was not open to objection as trenching upon their own field of taxation.[1] A similar provision should be made in the new constitution, but should have much wider scope. It will be the National Finance Commission, and not the Government of India, which will ensure the harmonization of taxation in the widest sense of the word. The Commission will be charged with specific functions, and occupy a position of dignity and detachment; and the control exercised by it will really not be control by the Government of India but by a national organ, specially created for safeguarding the highest interests of the country in matters relating to the finances of the Government of India, the Provincial Governments and the various local authorities. They will all send to the Commission drafts of their

[1] *The Joint Report*, para. 210.

proposals for the introduction of new taxes, or the revision of old ones, in time to enable it to satisfy itself that not only will these changes not involve an encroachment on the fiscal spheres of other governments, but also that they will not cause injury to the trade relations of the country, or give rise to double taxation, excessive burdens on particular sections of the community or on particular parts of the country, or tax discriminations. In short, the Commission will exercise powers analogous to those, referred to in Chapter V, which the German Reich has reserved to itself under Article 11 of the new constitution. The Commission will, on account of the nature of its duties, acquire an all-India outlook, and will judge the validity or otherwise of any proposed measures in the light of the facts relating to the fiscal systems of India and other countries, which it will have to collect and collate for the efficient discharge of its duties. Its functions in the domain of finance will be more or less judicial, and the Government of India will be guided by its advice and experience as much as the Provincial or local authorities, though the character of its functions will bring it into closer contact with the Government of India than with other public authorities.

The Government of India, as such, do not exercise any control over Provincial expenditure, but the Secretary of State does; and as all applications for sanction of the same are sent to him through the Government of India, the latter have an effective voice in the decision of matters with regard to which the sanction of the Secretary of State is required under the rules. It may be presumed that, under the new constitution, the Secretary of State will have nothing to do with Provincial expenditure, and it will not be necessary for the Provincial Governments to obtain his sanction for expenditure chargeable to their revenue and capital accounts. Should the Government of India, then, exercise any powers of control over the expenditure of the Provinces? To this question, in the form in which it is here stated, there need be no hesitation in giving a negative answer. The Provinces should be emancipated completely from the control of the Finance Department of the Government of India, and have final

powers over their budgets. The control, which is now indirectly exercised by the Government of India, is limited to—

(*a*) the pay, allowances, etc., of all-India Services;

(*b*) the expenditure of Provincial Governors;

(*c*) the creation of posts on a maximum rate of pay exceeding a certain amount, and the revision of establishments involving expenditure exceeding a certain limit; and

(*d*) capital expenditure upon irrigation and navigation works, including docks and harbours, and upon projects for drainage, embankment and water storage and the utilization of water power, where the original estimates exceed Rs. 50 lacs.

The first two categories are not important from a financial standpoint. If the Provinces are granted full autonomy, they will have complete control over the services; and it will only be necessary to safeguard the interests of the present members of all-India services. The Provincial Governors will, it may be hoped, become constitutional rulers; and their salaries and conditions of service will be laid down by statute or the rules made thereunder. The creation of new posts and the revision of establishment sought to be left to the Provincial Governments and their legislatures, and the present limits of pay and expenditure are unnecessary. Coming to the last category, there is room for some difference of opinion as to whether the Provinces should be free to incur expenditure to an unlimited extent on irrigation works and other projects of the same kind. These works will generally be constructed out of loan funds; and it will, as stated in a succeeding paragraph, be necessary to make provision for the regulation of expenditure when money is to be raised by borrowing. Apart from this consideration, some of these works will give rise to inter-provincial issues, and expenditure on them may have to be allocated between two or more Provinces. In such cases, it will be necessary to have some machinery for the settlement of the outstanding issues, the allocation of expenditure and the adoption of common policies and measures. The necessity of

co-ordination in such cases was pointed out in Chapter VI; and it is sufficient to add that, in all such matters, it will be in the interests of the Provinces themselves to take advantage of the advice and experience of competent officers in other Provinces, who may be in a position to give expert advice on projects for which large expenditure is to be incurred. It is not possible to avoid all risks in the undertaking of such projects; but it is desirable that the number of costly failures should be as small as possible, and that loan funds should be used to the best advantage. It will probably be necessary to have a standing All-India Board to which such matters may be referred, and whose advice will be sought and acted upon by all Provinces when they are about to embark upon very heavy capital expenditure. It is very difficult to say how far this Board should have definite powers to control expenditure. But the more it can make its existence felt, in regulating the course of provincial expenditure on capital works, without losing its advisory character, the more useful will it be. A great deal will have to be left to the traditions which this body can build up for itself. But, at any rate, it is clear that the control of departments of the Government of India over the Provincial Governments will have to be abandoned. Its continuance will be against the spirit of the new constitution.

The Provincial Governments were given powers, under the Government of India Act, 1919, of raising their own loans, subject to certain conditions; and some of them have made use of these powers. There are two arguments in favour of the Provinces having independent borrowing powers. The first is that such powers are an essential part of the complete financial autonomy of the Provinces. If they have their own revenues, the Provinces should be in a position to raise loans on the security of these revenues, and to determine the extent to which they will incur capital expenditure out of borrowed funds. This argument is not conclusive for the grant of independent borrowing powers to the Provinces. In the first place, the Government of India can never allow a Province to default or become

insolvent. The Government of India guarantee, tacit or express, will always remain behind Provincial loans. In the second place, there is no reason why the Provinces should not make use of the superior borrowing powers of the Government of India and get their loan funds through a central authority. There is no sense in the Provinces floating their own loans, when they can get the money cheaper on the credit of the Government of India. But it is possible that considerations of economy may come into conflict with those of autonomy, if the Government of India insists on scrutinizing the purposes for which the loans are required. This objection will, of course, not hold good, if the Government of India undertake to make money available to the full extent of the requirements of the Provinces without examining the purposes of the loans. The Provinces will, in that case, have to make provision for the payment of interest and for amortization; but that will not involve any restriction of their borrowing powers, and they may just as well waive the power of floating their own loans, and get funds for their capital requirements from the Government of India. This aspect of the matter is, however, important, and will be further dealt with in a subsequent paragraph.

The other argument in favour of the Provinces borrowing money on their own account is that they will thereby tap sources which will not be touched by all-India loans. This would be a valid reason for the Provinces raising their own loans, if the experience of those Provincial Governments, which have made use of these powers since the introduction of the Reforms, pointed to the existence of any hidden reserves of capital resources which could be drawn upon only by provincial loans. This hope was entertained by the authors of the Reforms, when they recommended the grant of independent borrowing powers to Provinces; but actual experience has belied this expectation. The Provinces have, in all cases, obtained their loan-funds from the same markets on which the Government of India usually depend for their internal loans, and, what is more, have had to pay higher rates of interest for those loans. The facts tabulated overleaf speak for themselves.

A statement, comparing the rates of interest paid by the Provincial Governments on loans raised in the Indian money market with the corresponding rates paid by the Central Government.

| Provincial Loans | Amount in lacs of Rupees | Effective rate of interest per cent | Rate of interest on Government of India loans in the same year | Difference in interest | Net loss per annum in the shape of interest in lacs of rupees |
|---|---|---|---|---|---|
| The Bombay Development Loan, 1920 ... | 9,39 | 7·13 | 6·5 | 0·56 | 5·26 |
| The United Provinces Development Loan, 1921 ... ... | 4,20 | 7·36 | 6·57 | 0·79 | 3·32 |
| The Punjab Development Loan, 1923 ... | 1,92 | 6·26 | 5·88 | 0·38 | 0·73 |
| The Punjab Development Loan, 1925 ... | 89 | 5·76 | 5·48 | 0·28 | 0·25 |
| Total ... | ... | ... | ... | ... | 9·56 |

The Provinces are thus paying Rs. 9·56 lacs every year for the privilege of exercising their newly acquired powers in respect of borrowing without any corresponding return. They have to obtain the sanction of the Government of India before raising these loans, and have to submit to any conditions which the latter may specify regarding the amount of the issue, the rate of interest, the form of the loans, etc. The loan-funds can, as a rule, only be used for productive purposes; and sinking

funds have to be provided. Under these circumstances, there does not seem to be any special gain in the Provinces issuing their own loans. The money market in India is still limited and extremely sensitive, and it is not possible to change its character in the near future. The central control of borrowing by the Provincial Governments, or authorities subordinate to them, is necessary, if harmful competition between them and the Government of India is to be avoided. The Provinces may have the constitutional right of borrowing on the security of their own revenues, subject to the sanction of the Government of India; but as the exercise of this right will neither result in economy nor in the increase of their financial powers, the Provinces will do well to do all their borrowing through the Government of India.

The existing arrangements for borrowing by the Provincial Governments are governed by the Local Government Borrowing Rules and the Government of India Resolution of 25 March 1925, according to the provisions of which the 'Provincial Loans Fund' was established. The Provinces can raise their own loans on the security of the revenues allocated to them. The loans can be raised only for purposes specified in the rules; and the intention of these rules is that loans for non-productive purposes should generally be avoided. For loans raised outside India, the previous sanction of the Secretary of State is necessary; and for those in India, that of the Government of India. The Provinces, as the table given above shows, have not so far raised loans outside India. The Governor-General in Council, or the Secretary of State in Council, as the case may be, can prescribe the conditions under which the loans are raised. The Provincial Loans Fund has been established to systematize the arrangements regulating advances from the Government of India to the Provincial Governments. The Fund is intended to be self-supporting; and is, for the present, financed by advances from the Government of India. All loans to the Provinces are made through this Fund, and their capital liabilities to the Government of India on the date of the establishment of the Fund have been transferred to it. The Provincial

Governments have to provide annually out of their ordinary revenues a sum sufficient to redeem all advances from the Fund within a period not exceeding eighty years. The rate of interest charged by the Central Government is determined on the basis of the cost of new borrowing. The standard rate of interest is charged on all capital expenditure, which can be classed as productive. For all other advances, the rate is one-fourth per cent above the standard rate. Sums borrowed for productive purposes cannot be diverted to any other purpose, and sums borrowed on special terms for specific purposes have to be applied to the object for which they are borrowed. The advances to the Fund are voted every year by the Legislative Assembly; and the approval of the local Legislative Council for expenditure from loan-funds has to be obtained in the form of demands for the grant of the necessary funds for the purposes for which they are required. The approval of the Central or Provincial Legislatures is not required for the terms on which loans are raised in the open market, or advances made to the Provinces from the Provincial Loans Fund.

These arrangements can be regarded as satisfactory, if the Government of India can raise sufficient money every year to meet their own capital requirements as well as those of the Provinces. In that case, the Government of India need not go into the relative merits of the schemes for which the loans are wanted, and can advance funds to the Provinces out of the Provincial Loans Fund to the full extent of their requirements, provided the latter are prepared to make suitable arrangements for the payment of interest and for amortization. But the capital requirements of public authorities in India are large and growing; and it is very doubtful whether it will always be possible to raise sufficient money in and outside India to satisfy the demands of all of them. If the funds available for capital requirements are not adequate for the needs of the Government of India and the Provinces combined, it will be necessary to arrange for their distribution on a basis which may be recognized as fair and equitable by the parties concerned. The authors of the Joint Report

suggested the appointment of a small committee, on which the Central and Provincial Governments might be represented, to settle the distribution in such cases.[1] This suggestion has in it the germ of the development of an institution, which ought to be an integral part of the system of financial administration in India. We have been spending large amounts on capital expenditure; and it is necessary to devise arrangements by which loan-funds may be employed to the fullest economic and social advantage. Sir Basil Blackett, in his budget speech of 1925, referred to in the preceding chapter, foreshadowed the establishment of an Indian body, corresponding to the National Debt Commissioners or the Public Works Loan Commissioners in England, for the administration of the Provincial Loans Fund and all other funds required for capital requirements. The Liberal Industrial Inquiry Committee[2] have suggested the creation of a Board of National Investment in Great Britain, which should take over the functions of the National Debt Commissioners and of the Public Works Loan Commissioners, and should discharge also some additional duties. According to the recommendations of the Committee, all capital resources, accruing in the hands of Government departments, and raised by the issue of special bonds, should be pooled in the hands of this Board; and that out of this pool should be financed the new capital expenditure of all central, local, or *ad hoc* official bodies. The Board would draw up a programme of capital expenditure, with reference to the amount of resources flowing into the pool, the state of the investment market, the urgency and importance of the demands upon it for advances and certain other factors. The Committee point out that the method and aims of such a Board would necessarily be matters of gradual evolution, but they anticipate that it would in time become a factor of the utmost importance in the development of the national resources of Great Britain. Mr. G. D. H. Cole, while approving of this

[1] *The Joint Report*, para. 211.

[2] '*Britain's Industrial Future*', being the Report of the Liberal Industrial Inquiry, pp. 111–15.

suggestion of the Liberal Industrial Inquiry Committee for the establishment of a National Investment Board, emphasizes the fundamental importance of a more effective utilization of the national economic resources as the first object of public economic policy.[1] In India, there are special circumstances which justify the creation of a body analogous to the one contemplated by the Liberal Industrial Inquiry Committee. If any country has reason to promote the utmost economy in the use of its available capital and to direct its investment into the most profitable fields of enterprise, it is India; for the extreme urgency of our needs for development is only equalled by the strictly limited character of our economic resources. We have to foster habits of thrift and economy, and to mobilize our savings by developing a banking organization more adequate for our national needs; but even then we cannot expect to find all the money that we require for the development of our resources within the country. We shall have to continue to raise loans outside India; but there are very good reasons for regulating the increase of our liabilities to foreign countries lest they should come in the way of our political progress. It is, therefore, necessary to have a national policy for financing schemes of development and an institution for administering it.

The evolution of a fully developed body for administering the resources available for capital requirements will, of course, take time; but we can make a good beginning by constituting what might be called a National Loans Council on the lines on which the Loans Council of Australia, referred to in Chapter V has been constituted. The Australian Council has, it will be remembered, been functioning since 1924, and is practically the central borrowing authority for the Commonwealth. It prepares plans, according to which borrowing operations are conducted, decides the order in which the Commonwealth, the States, and the bodies created by State legislatures shall come upon the Australian market; and loans in foreign markets are floated by it in the name of

[1] '*The Next Ten Years in British Social and Economic Policy*,' pp. 76–83.

the Commonwealth, and their proceeds distributed among the various public authorities according to the relative urgency of their wants. This, of course, means that the Council exercises a selective influence over the distribution of loan-funds, arranges the demands for capital in order of their importance, and indirectly draws up a programme of capital expenditure. The Council consists of representatives of the States and the Commonwealth; but they are there to develop and carry out a common policy, and not to promote the special interests of the Governments which they represent. In India, the National Loans Council will have similar, though not precisely same, functions. It will, in the first place, be in charge of the management of our public debt, and also of capital resources accruing in the hands of the different public authorities. These comprise service funds, provident funds, postal life insurance and life annuity funds, post-office cash certificates, the famine insurance fund, and the depreciation and reserve funds of the various commercial departments of the Government, and in the aggregate amount to Rs. 114·84 crores at the present time. These funds and others will be administered by the National Loans Council, and will be utilized, as now, for financing the capital programme of the Central and Provincial Governments. The Council will also administer the Provincial Loans Fund, and it may be the Railway Loans Fund, and similar other funds which it may be desirable to establish later on. All loans in and outside India will be issued by the Council, and have the guarantee of the Government of India, though they may not in all cases be issued in their name. The Council will distribute funds among all public authorities in India, according to the plans of capital expenditure prepared by it. It will probably be desirable to make a general survey of the country, similar to the one recommended by the Baxter Commission for the Union of South Africa, and referred to in Chapter V, as a basis for drawing up a programme of capital expenditure for the Central Government, the Provinces and the local bodies. The Council will every year prepare a Budget of Capital Expenditure, and provide money out of loan-funds for the different Governments. It will not arrogate to itself

the functions of the central or provincial legislatures, with regard to the capital expenditure of the Government of India or of the Provinces. Funds will be asked for by the Governments concerned in the form of demands for a grant, and the expenditure therefrom will be sanctioned by the Legislatures. The Council will only make funds available if they are required; and in allocating them, it will scrutinize the requirements of the different authorities not only from the point of view of finance but also of administration; that is to say, it will assess the relative importance of different schemes of capital expenditure. This is, of course, implied in the fact that it will prepare every year a Budget of Capital Expenditure on the basis of the results of a survey of the whole country. The constitution of the Council will have to be carefully considered, and the procedure of its work thoughtout in detail; but both the Provinces and the Government of India will, of course, be represented on it, and the co-operation of all the important banking institutions fully ensured. The National Loans Council will, in due course, assume other functions and extend the scope of its activities; but, even at the outset, it will discharge very important duties, and occupy a position of great power in our national economy. There is not the slightest doubt that this power will be used for the good of the country, if the Council is properly constituted, and animated by the right spirit.

There are four important financial functions, which are now being performed by the Government of India, but with regard to which it has been suggested that certain changes are necessary. These functions are resource operations, ways and means operations, accounts and audit. The first two are of a technical nature, and have to be explained. The resource operations are designed to provide adequate funds, at the numerous disbursing centres, for meeting the obligations of the Government of India, the Provincial Governments and other public authorities. There are 1,500 treasuries and sub-treasuries in India, and more than ninety branches of the Imperial Bank, which receive and pay out money on public account. The financial operations of the Govern-

ment have to be conducted in such a way that the public funds available at these centres may be adequate, and no more than adequate, for the obligations that have to be met. It is, therefore, necessary to prepare a forecast of receipts and disbursements at these centres, keep an eye on the actual incomings and outgoings from month to month, and transfer all surplus funds from centres which do not need them to those which do, or to the public account of the Imperial Bank, in order that a balance may be maintained between the receipts and disbursements and the unnecessary locking up of funds in the treasuries avoided. These operations are considerably facilitated by transferring funds from the paper currency reserve to the treasury balances, or vice versa, according to a system which is very efficient and economical, but which cannot be explained here, as it is somewhat complex, and it is not possible to describe it in a few words. Suffice it to say that the Government of India have, by facilitating these transfers between the two funds, reduced the total amount of balances in the treasuries, and transferred them to the Imperial Bank, which is a great gain from the standpoint of Indian banking, as the process has increased the amount of liquid resources available for the use of the business community. As far as the Imperial Bank is concerned, the Government of India have very little to do with the provision of adequate funds at different centres, so long as the funds in the public account are sufficient for meeting the demands of the public authorities. The agents of the branches of the Imperial Bank are given information as to the likely receipts and disbursements on account of the Government at particular places, and are also apprised of any heavy payments that may be in sight; but the Imperial Bank has to make its own arrangements for the distribution of funds, though it is to a certain extent helped by Government by being allowed to make use of the arrangement by which funds are transferred by interchange between the currency reserve and cash balances. If the Imperial Bank increases the number of its branches, or should a Central Bank be established and assume responsibility for making payments for Government through

its own branches or with the help of auxiliary institutions, the Government of India will be relieved of the duty of providing funds at those places at which the Central Bank or its allied institutions does this work. In countries where banking is fully developed, and where there is a wide diffusion of banking facilities, the necessity for resource operations does not exist. The Government banker can in such cases be depended upon for undertaking this function. But, in India, it is very doubtful whether the Government of India will be able to relieve itself entirely of this responsibility for some years to come. There are more than 500 towns, with a population of 10,000 or more, which are without modern banking facilities ; and the work of bringing these places within the ambit of a well-developed banking system will necessarily take time. The Government treasuries and sub-treasuries will have, therefore, to be maintained for the transaction of financial business at such places, though their number and importance ought to decrease with the development of the Indian banking system. The working of the treasury system is, as already stated, very closely associated with our paper currency system ; and as its efficiency depends upon the mobility of funds from one centre to another, and that can best be promoted by a central authority, 'resource' ought to remain a function of the Government of India. It will have to be performed in close co-operation with the Central Bank ; and that is another reason for entrusting it to an authority which has a wide jurisdiction and an equally wide horizon in financial matters. The Provinces will lose nothing by letting the Government of India carry on this work for them ; and the country as a whole will have the advantage of co-ordinated action in a field in which division of responsibility means waste and inefficiency. If the Provinces get money, whenever and wherever they want it, they can leave it to the Central Bank and the Government of India to make the arrangements by which they are placed in funds. The interests alike of efficiency and economy require that 'resource' should remain a central function.

The existing system is responsible for a division of administrative functions between the central and the

provincial authorities, with regard to the working of treasury system, which need not be continued. The actual work of receiving money or making payments is done by the Treasury Officers, who are employed and paid by the Provincial Governments; and the District Officers are also, to a certain extent, responsible for the efficiency of the system. But the Treasury Officers work under the direction of the Deputy Controllers of Currency, so far as the custody and transfer of funds is concerned, and under the Accountants-General, for accounts purposes. An officer subordinate to the Accountant-General inspects the treasuries once a year, to see whether the procedure prescribed for the transaction of business is strictly adhered to. His report is submitted in two parts—one for the Accountant-General, and the other for the Deputy Controller of Currency—and action on the points raised in the report has to be taken by the District Officers. The Accountant-General and the Deputy Controller of Currency are both officers of the Government of India; but they have to enforce the observance of rules by the Treasury Officers through the District Officers of the Provinces. Though there is no cardinal objection to the Government of India making use of the agency of the Provincial Government for the performance of certain functions, the complication which arises in this case, on account of the Treasury Officers being the officers of the Provincial Government, is unnecessary, and can be avoided by bringing the personnel of the Treasury department under the exclusive control of the Government of India, and charging its cost to the central revenues. The treasuries should become merely counters over which money is paid and received on behalf of the public authorities, and should be in the charge of officers who are under the Controller of Currency and his deputies.

The cognate function, known as the ways and means operations, is also in the hands of the Government of India. The revenue received by the revenue-collecting departments, and the receipts of all other departments, both of the Government of India and the Provinces, are paid into the nearest treasury or branch of the Imperial

Bank; and the money thus received becomes a part of the general balances, which constitute a fund in which there are no compartments. It is one undivided whole, and can be drawn upon for meeting all public charges, whether central or provincial. As the Government of India have taken upon themselves to provide funds for the payments of the Provincial Governments at all disbursing centres, there is no distinction between central and provincial revenues in the common reservoir of cash resources; and the revenues credited to provincial accounts are merely book entries, and cannot be differentiated from the revenues of the Government of India and their quasi-commercial departments. This amalgamation of balances has been objected to by responsible authorities, and it has been held that the separation of provincial from central balances is essential for the grant of financial autonomy to the Provinces. The Provinces should, it is contended, be made the 'custodians of their public accounts', if they are to have real independence in financial matters. 'The revenues allocated to local Governments,' to quote from the Report of the Muddiman Committee, 'must in fact be separated and held in separate accounts from the central revenues before anything in the nature of Provincial autonomy could be set up';[1] and, in another paragraph of their Report, the Committee said 'that appreciable further advance towards autonomy in provincial finances depends on the separation of provincial balances from the balances of the Government of India'.[2] The Committee were persuaded to take this view by two highly placed financial officers of the Government of India—Sir Frederick Gauntlett and Mr. J. E. C. Jukes—both of whom advocated the separation of provincial from central balances in their evidence before the Committee. Sir Frederick Gauntlett was of opinion that 'the recognition of a right to separate balances almost necessarily seems to imply the recognition of a right to a larger freedom from external financial control.

[1] *Report of the Reforms Enquiry Committee*, p. 44, para. 15.
[2] Ibid. p. 96, para. 116.

Moreover, until a Government has its own separate balances, it cannot adequately realize the importance of financial considerations'; and Mr. Jukes held that 'it would undoubtedly be a considerable advance in the direction of provincial autonomy if the local Governments were permitted to assume the custody of their own balances, and their procedure in the matter of withdrawal, transfer and disbursement of provincial moneys'. These extracts have been quoted to indicate the weighty character of the evidence in support of the case for the separation of provincial balances. If it is not possible to have provincial autonomy without introducing this change, the change will have to be made, even if certain financial considerations can be urged against it; but we must examine the position a little more carefully before we can understand the relation between ways and means and provincial autonomy.

The ways and means operations of the Government of India, though closely connected with their resource operations, are distinct therefrom, and will still have to be carried on, even when the latter are taken over by the Central Bank and its auxiliaries.[1] The reservoir of cash balances is a pool which has many inlets and outlets. Into it flow the revenues derived from taxation, Central and Provincial, receipts of the quasi-commercial departments, proceeds of rupee and sterling loans, repayments of loans advanced by the Government of India to the Provinces and local bodies, the different kinds of receipts which constitute the unfunded debt of the Government of India, and all the miscellaneous deposits which accrue in connexion with the administration of Central and Provincial subjects. All payments, chargeable to the revenue account of the Government of India and the Provinces, or on account of their expenditure—both revenue and capital—on their quasi-commercial departments, payments of interest on and repayment of the capital of funded and unfunded debt, advances to the

[1] The object of their ways and means policy is to ensure that cash in hand shall at all times be sufficient for meeting all public charges.

Provinces out of the Provincial Loans Fund, and withdrawals of funds temporarily deposited with Government, all come out of this common reservoir. The inflow and outflow of moneys has to be so regulated that at no time will the cash in the reservoir be depleted below a particular limit; and, generally speaking, its increase beyond a certain limit is also considered undesirable and avoided. The balances are partly located in England; and remittances from India are effected through the purchase of sterling bills, the funds for which are drawn from the cash balances in India. Provincial revenues derived from taxation, the unspent portion of loans borrowed by them and deposits in connexion with the administration of Provincial subjects merge into these balances; and the Central Government undertake to make money available to the Provincial Governments at the times and places at which they desire to draw it. In other words, the Government of India are the universal banker for all public authorities, including the Provinces; have the use of their balances and deposits for their own purposes; and in return are ready to make all payments for them. The Provinces, if they are to be autonomous, have a right to expect that their balances and those of the authorities subordinate to them should be at their disposal in the same way, and to the same extent, as they would be if they had a separate account of their own with a Central Bank. If they are in a position to draw on them according to their own needs and judgment, the mere fact of their having a banking account with the Government of India instead of a joint-stock bank cannot in any way detract from their position as autonomous units of the Indian Federation.

Regarding the deposit of the provincial balances with the Government of India in the light of a banking transaction, the present position is, however, far from satisfactory. Its most striking feature, and one which is open to serious criticism, is that it is not possible to give the approximate position of a Province from month to month or to say, at any given time, whether it has an overdraft or a surplus in its banking account. No distinction is made, at the initial stages, between

a payment on account of the Central Government and a payment on account of a Provincial Government. The exact position of the Provinces is ascertained at the end of the year; and it is only then that their pass-books are, so to speak, written up. It is obvious that it is very unsound banking, when the clients of a bank can draw on their accounts without knowing for months after the transactions whether they have overdrawn or underdrawn their accounts. The Central Government do not pay any interest on provincial balances, unless their amount is in excess of Rs. 25 lacs (for Assam, the minimum limit is Rs. 10 lacs), and they are deposited for a period of not less than six months. The interest allowed in such cases is one per cent less than the rate charged by the Government of India during the period on advances to the Provincial Loans Fund on deposits, which are initially declared fixed for twelve months and over, and at two per cent less for shorter periods. Departmental and judicial deposits, arising out of the administration of provincial subjects, which in the aggregate amount to over Rs. 15 crores, are, as already stated, merged in the general balances; and the Government of India do not pay any interest on them. These sums are, of course, eventually withdrawn; but they represent a constant balance, which can be and is used for financing the ways and means programme of the Government of India. The Provinces are not allowed to reckon these deposits as parts of their balances or use them for their revenue or capital expenditure.[1] It is unnecessary to add that from the financial standpoint, even apart from the political, some change is clearly required; the only question is the form which it should take.

[1] According to Rule 21 of the Devolution Rules, the Governor-General has the power to require any Provincial Government to regulate its expenditure in such a way as not to reduce the balance at its credit in the public account on a specified date or dates below a stated figure. This power is to be exercised 'in the financial interests of India as a whole', when it is necessary to invite the Provinces to co-operate in conserving the financial resources of the State in the case of war or a similar crisis of first-rate importance.

The Reforms Enquiry Committee have suggested that the provincial balances should be separate and held in a separate account. The balances, in that case, will presumably be deposited with the Imperial Bank; and the Provinces will use the agency of the Government of India for their resource operations, i.e. for making funds available at places at which the Imperial Bank has no branches, and the remittance and transfer of these funds will be effected by the same agency. What will be the result? The Provinces will become responsible for their own ways and means; that is to say, they will regulate their incomings and outgoings in such a way as to have a surplus balance with the Imperial Bank or arrange, if necessary, for temporary advances from it. They will, if their balances grow unduly large, invest them for short periods, or use them for capital expenditure if the excess is of a permanent character. The deposits accruing from the administration of their services will, of course, be at their disposal; and as their amount is large, they will, in the words of Mr. Jukes, 'be far more than sufficient to place the Provinces in funds to meet their day-to-day requirements.' They will not get any interest on their current account, and will have to pay for the transfer and remittance of funds through the agency of the treasuries of the Government of India. There is nothing to be said against this change so far as these effects are concerned. But it will have another effect, which will involve financial loss and will, on that account, be undesirable. There is at present a single Government balance, the amount of which is determined by the receipts and disbursements of all public authorities. If each Province has its own account with the Imperial Bank, there will be ten separate balances, nine Provincial and the tenth that of the Government of India; and their total amount will, of course, exceed the amount which is now considered sufficient for the needs of the Central and Provincial Governments. This, however, is unnecessary, since all the advantages of this change can be realized without complete separation of provincial balances. The accounts will have to be so maintained that the exact position of each Province can be known at

the end of every month, if not oftener; and each Provincial Government can either draw to the extent of its balance or get a temporary advance from the Government of India, or, it may be, from the Imperial Bank. It should also have the liberty to withdraw its balances, and invest them for short periods in treasury bills or other short-dated securities, if it thinks that it can thereby get a better return than it would by leaving them on deposit with the Government of India. Miscellaneous deposits and the balances of local authorities will be credited to the account of the Provinces; and they will be allowed to use them as freely as their own balances. All these changes can be made, without the necessity of having ten public accounts with the Imperial Bank. Provincial autonomy will certainly not be advanced merely by increasing the public deposits of the Imperial Bank; and the Provinces can be granted the freedom to use their balances in their own way without impairing the efficiency which results from the Government of India being 'the custodian of public accounts'. The resource and ways and means operations of the Government of India represent what are really banking functions, and must be performed by them owing to the undeveloped state of banking in India. In the course of time, resource operation will, as pointed out above, be taken over by a properly constituted Central Bank; and the *modus operandi* of ways and means will also be considerably modified. We have to regard these arrangements from a functional standpoint; and if we do so, we shall realize that considerations of economy and efficiency alike require that the Government of India should have the custody of all public balances in India. What is of real importance to the Provinces, is free use of their balances, and not the custody of them; and so long as they have the former, they need not insist on having a hand in the management and distribution of the public 'till money'.

The changes proposed with regard to the banking arrangements of the Provinces make a change in the system of public accounts necessary. It is important that, at least once a month, the Provincial Governments

should be able to know the amount to their credit, and be able to regulate their withdrawals in the light of this knowledge. But there is another reason which makes it necessary to change our system of accounting. At present, audit and accounts functions are combined, and performed by officers of the Central Government. The Accountants-General, who maintain the accounts both of the Central and Provincial Governments, and also audit them, belong to an all-India service, the expenditure on which is a charge on central revenues. The Accountants-General, as accounts officers, perform what are really executive functions. The bills are provisionally classified by the treasuries, but their detailed classification is done in the office of the Accountant-General; and then the accounts are compiled according to departments and territorial units. The form of the accounts corresponds to the form of the budget estimates; i.e. the major, minor and sub-heads, under which the figures of anticipated expenditure are arranged in the estimates, are the same as those under which the figures of actual expenditure are compiled in the accounts. The reason for this correspondence is that, without it, it is impossible to ensure that in actual practice the sanctioned estimates will not be exceeded. It is the duty of the Accountants-General and their subordinates to compare the figures of expenditure, month by month, with the estimates, and so help the heads of departments to enforce what is known as the scheme of appropriations. They warn the officers concerned either to slacken their pace of expenditure or to ask for additional grants, if they think that the expenditure will, if allowed to proceed at that rate, be in excess of the appropriations. This is a very important duty, and should devolve upon the Finance Departments and the officers under their control, for they are responsible for watching the state of Provincial finances during the year. The Accountants-General have also to help the departments in preparing the budget estimates, and to criticize them in the light of the actuals of the past year. This is, again, an executive function which forms part of treasury control, and ought to be performed by officers who receive their directions from the

Provincial Chancellors of the Exchequer. The Inchcape Committee advocated a change in the existing system, because they considered it wrong for the Provincial Governments to require officers, who were not paid by them, to perform duties in connexion with the preparation of their estimates. This is, however, the least important objection against the existing system. The real reason why it has to be changed is that it militates against the efficiency of treasury control, and makes it necessary for the Provincial Finance Departments to use the agency of officers, who are not subordinate to them, for carrying out their most important duty. The accounts officers ought to be officers of the Provincial Governments, and work under the administrative control of their Finance Departments.

There is another and a wider aspect of the matter, which may also be briefly considered. Under the existing system, audit and accounts duties are combined. Accounts duties are, as remarked above, executive duties; while audit is, or ought to be, a function of a different order, and can very well be compared to the judicial function. Audit cannot be efficient unless it is independent; and the audit officers ought to be able to do their work without fear or favour. The Accountants-General, as audit officers, are subordinate to the Auditor-General, who is independent of the Government of India; but their independence is more or less illusory since, as accounts officers, they are directly under the Finance Department of the Government of India. As it is not possible to have unity in duality, the Accountants-General are not really independent; and they must be relieved of their accounts duties, if they are to take their proper place in the financial administration of the country. The independence of the Auditor-General himself is also impaired by the fact that he is under the Secretary of State, who is really the Chief Executive of the State; and his independence of the Government of India is only independence of a subordinate branch of the administration. In spite of this fact, the Auditor-General does occupy a position of dignity and importance; and if his officers are made independent of the Government of India,

their status will be raised, and they will do their work with greater independence. It may be hoped that, under the new constitution, the Auditor-General will be made directly responsible to the Indian Legislature, and will conduct the audit of accounts against appropriations and sanctions on its behalf. He ought, in that case, to have an organization at his command, which can direct the search-light of scrutiny on to the entire financial administration of both the Central and Provincial Governments, and function as an efficient instrument of supervision and control. Sir Frederick Gauntlett has defined audit as the 'scrutiny of expenditure with the rules issued by the competent authority'; and if the audit officers examine the accounts, not only from the point of view of their conformity to the letter of the rules, but also their spirit, they can render a very important and useful service in ensuring efficiency and honesty in the conduct of the financial affairs of the State. Since the introduction of the Reforms, a separate branch has been constituted in each audit office, consisting of picked men, who are charged with the duty of conducting what is called the higher audit. This section works under the personal guidance of the Accountant-General, and is expected, to quote from a well-known despatch of the Government of India, 'not only to see whether there is quoted authority for expenditure, but the necessity for it'. It is not known how far the higher audit sections have really been performing the functions for which they were constituted; but it is necessary to go a great deal further, and transform the whole of the audit into what is now known as the higher audit. The fidelity to rules is important, but fidelity to 'the legitimate principles of public finance' is much more so; and the real purpose of audit scrutiny is to 'ask every question that might be expected from an intelligent tax-payer, bent on getting the best value for his money'. The separation of audit from accounts ought to enable the audit officers to devote their whole attention to securing the observance of 'the legitimate principles of public finance' and to shake off the unwholesome effect of the multiplicity of rules, which has, as is generally admitted, weighed very heavily on them in the

past. It is difficult to infuse a spirit of intelligent enquiry into a Government department; but the difficulty of the task is greatly increased, if there is a confusion of duties and functions. Audit should, therefore, be separated from accounts, in order to secure full independence for the former, and raise it to a different and higher plane of achievement.

The organization of the audit and accounts departments will, if this measure is introduced, be similar to their organization in the United Provinces and the Railways, which have already separated audit from accounts. The accounts departments will be under the Finance Departments of the Governments, whose accounts they maintain; and each department will have an accounts officer of its own. It will be his duty to classify and compile accounts, to apply an 'internal check' by the pre-audit of bills, to make payments by cheques, and to help the head of the department to which he is attached to exercise closer control over the expenditure of funds and the preparation of estimates. These officers, though closely associated with the administrative departments, will not belong to those departments. They will be officers of the Finance Department; and it will be their duty to exercise supervision on behalf of the latter, and they will be directly responsible to it for the efficiency of their work. In matters relating to their promotion and prospects, they will be independent of the administrative departments; and will report to the Finance Member, through the Chief Accounts Officer, any differences that might arise between them and the heads of the administrative departments. They will work in close co-operation with the administrative officers, but will not in any way be subservient to them.

The audit officers will be officers of the Government of India, but will not be subordinate to the latter's Finance Department. They will be under the Auditor-General who, it may be assumed, will be responsible to the Central Legislature. They will audit the accounts of all public departments—central, provincial and quasi-commercial—and report the results of their scrutiny to their respective Governments, who will submit them to

the Public Accounts Committees of the legislatures, and take the necessary action on the recommendations of the Committees. These officers will be recruited by the Public Service Commission, and will be subject to the public servants' conduct rules; but, taken together, they will be an autonomous public service corporation, and required to perform one of the most important financial functions. Freed from the obsession of codes and formalism, they will rely more on their own judgment and discretion than on merely mechanical industry; and experience of an audit conducted on these lines will enable them to enunciate general principles of wide applicability, and help the Government to formulate rules in the light of these principles. The general framework of accounts will be determined by the Finance Department of the Government of India, both for the Central and Provincial Governments, but it will very largely be guided by the Auditor-General and his officers in the discharge of this duty. The audit of revenues and stores is at present not as extensive and intensive as it ought to be; special measures will have to be adopted for improving the efficiency of the department in these respects. In view of the importance of the quasi-commercial activities of the State in India, the audit of commercial accounts will have to be made the concern of a specialized branch of the audit service. Though the services of the Audit Department in the past are not to be under-rated, there is no doubt its future will be much greater than its past, if it can be constituted into an autonomous, self-regulated, organization, imbued by the spirit of public service in the best and highest sense of the word.

There are two objections to the separation of audit from accounts. One is that of cost. It has been estimated that the reform will cost Rs. 35 to 40 lacs, if it is to be introduced in all Provinces and all departments. The measure has already been in operation in the United Provinces since 1926, and has been introduced on all Railways since April 1929. It will have to be extended to the other commercial departments and the remaining Provinces. This will involve an additional expenditure of about Rs. 20 lacs. The amount is large;

but it will pay for itself many times over, if all the anticipated advantages of the measure can be realized in actual practice. On the other hand, if it merely means that the reconstituted accounts and audit departments will, with an enlarged staff, be doing practicably no more than they are doing to-day, only doing certain things twice over and perhaps a little more intensively, the additional expenditure will be sheer waste, and the administrative system unnecessarily complicated. If, however, the internal check takes the place of a merely technical audit, and enables the accounts officers to exercise closer control over appropriations and estimates by coming into close contact with the realities of the administration, and, what is more, if audit comes to mean the application of organized common sense to the scrutiny of public expenditure, and is really made independent of all executive authorities, the expenditure will be a very good investment, and give an adequate return to the tax-payers in a number of ways. That, of course, means that some one with imagination will have to set to work to clear the weeds of rules and regulations, and let in fresh air into the nooks and corners of the audit offices ; but granting that this can be done, the expenditure will be certainly worth while. The other objection to this change is that the audit officers will not be able to keep themselves in touch with the day-to-day administration, and will neither appreciate nor have any insight into the complexity of the problems with which they will have to deal. This objection loses much of its weight, if we can assume that the accounts officers will not be in league with the administrative officer to thwart the scrutiny of the audit officers, and to withhold facts from them without which they will not be able to perform their duties efficiently. The fact that audit and accounts officers will, in future, perform distinct duties does not mean that there will be no co-operation between them. They need not start playing a game of hide and seek, merely because they will specialize to a much greater extent than they have done up till now, and will be responsible to different authorities. The accounts officers will, as stated above, be representatives of the Treasury ; and the Treasury and

Audit will, it may be assumed, be allies and not mutually hostile or even apathetic organizations. Audit will help the Treasury to enforce economy and regularity in the conduct of the financial affairs of the State, and will, therefore, receive all possible help in return in the discharge of its own duties. Treasury control and audit scrutiny are complementary functions, and the departments charged with them will be only helping themselves by helping each other. The separation of audit from accounts, it may be repeated, is a reform which will facilitate the necessary adjustments between the Government of India and the Provincial Governments and to stimulate both the departments concerned to greater and more useful activities.

There is another matter, comparatively speaking of minor importance, with regard to which it is necessary to come to a decision. India is a country of famines; and famine relief should be regarded, as it has been since 1878–79, an ordinary incident of Indian administration, and adequate provision made for the purpose. The position before the Reforms was that famine relief expenditure was shared between the Central and Provincial Governments in the proportion of 3 : 1; but under the Reforms famine relief was made a Provincial liability, and the Provincial Governments were required to make annual assignments for it. These amounts were to be spent for actual relief, if necessary; but the unexpended portion of the assignment was to be credited to the Famine Insurance Fund, which was treated as a cumulative insurance against famines. The annual contributions were calculated according to the average expenditure of the Provinces on famine relief and on the construction of protective works; but after some years it was found that these amounts were unnecessarily large and could be reduced without increasing the risks of famines. Under the amended Devolution Rule 29, which governs the famine relief assignments and expenditure, the amounts which the Provinces have to provide have been reduced, and the maximum limits up to which they have to accumulate funds have also been lowered. The total amount of the annual contributions which all the Provinces, taken

together, have to make is Rs. 42 lacs, and the minimum aggregate amount up to which the fund has to be built up, unless it is reduced by withdrawals for famine relief, is Rs. 262 lacs. On the average of the balances held in the Fund, the Government of India pay interest at a rate which is one per cent less than the rate charged for advances to the Provincial Loans Fund. The Famine Insurance Fund forms part of the general balances of the Government of India, and is used for financing their ways and means programme, which includes advances to the Provinces themselves through the Provincial Loans Fund. The balance to the credit of this Fund on the 31st March 1927, amounted to Rs. 5·74 crores, on which interest was paid at one per cent under 3¾ per cent (the rate charged by the Government of India for advances to the Provincial Loans Fund), i.e. at the rate of 2¾ per cent. Now the Provinces borrowed Rs. 7·30 crores in 1926–27, namely Rs. 4·30 crores for productive purposes, for which they paid 5 per cent and Rs. 3 crores for other purposes, for which they paid 5¼ per cent. Had they been allowed to draw on their balance of Rs. 5·74 crores in the Famine Insurance Fund, they would have saved, in net interest charges, the difference between 2¾ and 5¼ per cent (i.e. 2½ per cent) on Rs. 3 crores and 2¼ per cent on the remaining Rs. 2·74 crores. This is an unnecessary burden on Provincial finances; and if the Provinces are to be free to use their own balances, there is no justification for not allowing them to spend the unexpended portion of the annual assignments for famine insurance for the avoidance of their own debt. It is doubtful even whether it is necessary any longer to impose on the Provinces an obligation to make provision for famine relief under the Statutory Rules; but even if they cannot be given full liberty of action in this matter, they should, at least, be allowed to use their balances in the Famine Insurance Fund as a set-off against their liabilities to the Provincial Loans Fund. This will amount to their using their balances for the avoidance of debt. The expenditure on famine relief fluctuates very widely from year to year. Provincial expenditure for the purpose fell from Rs. 85·40

lacs in 1921–22 to Rs. 5·10 lacs in 1922–23 ; and these are the two extremes for the period 1921–22 to 1926–27. It is necessary, therefore, to insure against the occurrence of famines by making annual assignments. The assignments under the amended rules are not unduly large, and may be continued ; but the existing arrangements should be so changed as to enable the Provinces to have a square deal in the matter.

This chapter may be concluded with the general observation that in regard to the matters discussed in the foregoing paragraphs and similar other matters, as in the whole domain of federal finance, we should take a functional as distinguished from the merely constitutional standpoint. There are certain functions which can best be performed by the Central Government, and there are others which ought to be assigned to the Provincial Governments. This is the paramount consideration to be borne in mind in determining their reciprocal financial relations. It has to be remembered that Provincial autonomy is an essential condition of the health and vigour of the entire body politic; and ought, in all fundamentals, to be ensured. But there is no inherent conflict between Provincial autonomy and the integration of national life ; and it is from the latter standpoint that the functional aspect of financial re-adjustments has a special significance and importance. The distinction made in the first chapter—federalism old and new, federalism of powers and federalism of functions—is, properly understood, a very illuminating distinction, and will save us from numerous pitfalls if we constantly bear in mind its full meaning and value. India, it is well worth while repeating, ought to be a federal State according to the new, and not the old, conception of federalism.

# CHAPTER IX

## *The Indian States*

The question of the relations of the Indian States with British India, is going to become a live issue in the immediate future. Its constitutional aspect has forced itself upon the public attention, and is likely to receive even greater consideration than the financial; but, as pointed out in the first chapter, it is necessary to take a realistic view of the financial relations of the Indian States and British India, and to face the facts without raising any subsidiary issues. It cannot serve any good purpose to get involved in the discussion of the scope and limits of the States' sovereignty in this connexion. The doctrine of sovereignty has, in the history of political thought, been used for all kinds of ulterior objects, and has been made, in the words of Mr. Paul W. Ward, 'a cloak for the purposes of such groups as controlled the specific political structure'. 'It positively prevented', to quote from the same author, 'analysis of concrete factors in the political situation. It hindered the solution of social problems by placing the ghost of authority, which never in fact existed, athwart the path of enquiry.'[1] We have to analyse 'concrete factors in the political situation' in order to find a basis for financial settlement between the Indian States and British India, and not to allow 'the ghost of authority' to be placed 'athwart the path of enquiry'. With regard to all vital issues, there cannot be any difference of opinion. The Indian States, whatever else their status may be, cannot be Foreign States in their relations with the Government of India, even if the latter are made responsible to the Indian Legislature; and any attempt to convert them into an 'Indian Ulster' must be as-

[1] P. W. Ward: *Sovereignty*, p. 170.

futile as it is mischievous. Even if, for the sake of argument, it is conceded that the Princes 'should not be transferred, without their agreement, into a relationship with a new government in British India responsible to an Indian Legislature',[1] still the fact remains that, in certain matters, the Government of India have to be the agent for carrying out national policies; and the Indian States cannot afford to refuse to parley with them or to arrive at an understanding with them with regard to the performance of certain functions of national importance. They cannot have any foreign relations with other countries in or outside the British Empire. They cannot maintain armies, independent of the Indian High Command. There has to be a very large measure of co-ordination in matters like railways, roads, posts and telegraphs and irrigation; and there cannot be different systems of currencies or conflict between the different fiscal authorities within the country. In economic matters, there cannot be two Indias. We have, as a matter of sheer necessity, to knit the different parts of the country into one organic whole, or cease to exist as a nation. It is well to recognize the logic of facts, and submit to it with a good grace. If it is admitted—and it cannot but be admitted—that, in all these matters, it is simply inconceivable to let disintegrating factors come into play, it follows that undue emphasis on the terms of treaties, *sanads* and engagements can do no good. It is no use trying to embalm the dead past. 'Paramountcy' has already made these 'contracts' out of date, and the changing times make further re-adjustments inevitable. It is as much in the interests of the Indian States, as of British India, that the re-adjustments which are necessary to find full scope for the vital forces of national life should be made, and a stable basis found for their harmonious operation in the future. This can be done, not by stressing differences, but by seeking common ground and arriving at mutual understandings.

The success of this attempt will depend upon two conditions. First, the settlement must be based on a

[1] *The Report of the Indian States Committee*, p. 58.

large measure of mutual agreement. The Indian States have, in the past, too often been coerced to adopt measures and policies against their own free will. The Indian States Committee have found it impossible to define paramountcy; which is another way of saying that in the future, as in the past, there will be no limits to the extent to which the Crown will have the right to intervene in the affairs of and impose its decisions upon the Indian States. The Princes have fully appreciated the implications of the dictum that the principle of paramountcy must remain paramount; and in spite of the assurance that 'on paramountcy and paramountcy alone can the States rely for their preservation through the generations that are to come',[1] they are trying to win general acceptance for the view that paramountcy must know some bounds. But it is not likely that they will succeed; for, if they are to be protected by the supremacy of the Crown, they cannot deny its absolute character. This aspect of the matter is, however, of no interest from the point of view of the solution of the problem of the financial relations between the Government of India and the Indian States, since, with regard to them, the bilateral character of the obligations has to be accepted, and we have to ensure that the Indian States will have an effective share in determining and administering policies, which affect the well-being of the country as a whole. For that purpose, provision has to be made for deciding questions of common interest by mutual consultation and joint deliberation. It is not possible to discuss how this end is to be attained. But there cannot be any doubt that the machinery for the elaboration of concerted measures must be an integral part of the new constitution. There can be only two ways whereby policies relating to matters, in which there is identity of interests between British India and the Indian States, can be executed. One is dictation by a supreme authority, and the other is persuasion. Even if the Indian States acquiesce in the proposition that the British Crown must remain the final arbiter of their destinies, it is not possible for British

[1] *The Report of the Indian States Committee*, para. 57.

India to agree to arrangements which rest on such premises. The British Crown may continue to exercise the right to dictate to the Indian States; it cannot dictate to the rest of India without a complete negation of her right of self-determination. If self-governing India is to be a free agent, the only method by which the decision of such questions can be worked out is mutual persuasion. It is not enough to make arrangements merely for negotiation. There must be provision for the settlement of outstanding issues, for determining policies, and for regulating the course of action in particular cases. The Indian States may, if they so choose, continue to have direct relations with the British Crown; but the necessity of working in close co-operation with what is now called British India, but will be self-governing India of the future, cannot be thereby obviated. There must, therefore, be adequate arrangements for the enunciation and execution of common policies; and they must be based on consent, and not on coercion. It is, as remarked above, not possible to make concrete proposals for creating political machinery for the purpose. But the imperative need of such machinery may be postulated as the working hypothesis on which the arguments of the succeeding paragraphs are based. The Indian States have to take their rightful place in our national life, and must have a share in the formulation of our common policies. Without this, complete harmony cannot be secured in the working of our political system.

The other condition, which is essential for finding a basis for the financial settlement, is that the obvious fact that all the Indian States cannot be treated alike should be clearly recognized. Uniformity of terminology has, as was pointed out by the authors of the Joint Report, tended to obscure distinction of status; and practices appropriate in the case of lesser chiefs have been applied in the case of greater ones also. A line has to be definitely drawn between the States, which can be accorded financial autonomy, and others which must have very limited financial powers. It may not be desirable to re-classify States for ceremonial purposes; but it is

impossible to make the necessary re-adjustments between them and British India, if the differences in kind, which exist between the States, are not taken into account in the arrangements of the future. The Indian States are, as Lord Lytton wrote in one of his letters to Lord Salisbury, 'easily affected by sentiment and susceptive to the influence of symbols to which the facts may imperfectly correspond'.[1] This is, unfortunately, as true to-day as it was in 1877; and the heart-burning, which the Indian States Committee apprehend, if an attempt is made to re-classify the States, can be attributed to their being susceptive to the influence of which Lord Lytton speaks. But we are concerned here with facts and not with symbols; and though the latter may be allowed to exercise their soothing influence over the Princes, it is on the basis of the former that we have to make our financial re-adjustments. Two hundred and eighty-six States of Kathiawar and Gujarat and forty-one others, which have been placed in class three by the Indian States Committee, and whose total revenue is only Rs. 74 lacs, cannot possibly have any independent financial powers. There are about twenty States, which have each an annual revenue of less than Rs. 1,000; and there are states like Pimlaidevi, Palashvir and Vadhyawan, whose annual revenue is Rs. 88, 86 and 60, respectively. It is evident that, whatever the position of the rulers of such States may be in the pantheon of ruling chiefs, they cannot have a fiscal system of their own; and must, from the financial standpoint, be regarded as petty estates, which cannot possibly be permitted to create complications in the working of our financial system. One hundred and twenty-seven States, the rulers of which are represented in the Chamber of Princes by twelve members of their own order elected by themselves, and whose total revenue is only Rs. 2·89 crores, are also very small principalities, with an average population of about 62,000, and cannot really be administered as self-contained units. The rulers may retain their titles, and have, on a limited scale, the administrative paraphernalia, to

[1] *The British Crown and the Indian States*, p. 75.

which they attach so much importance ; but they will have to combine with other States or in some cases, it may be, with adjoining Provinces, for discharging functions which, by themselves, they are not in a position to undertake. The people of these States will not be able to develop their material or moral resources, unless they are organized into larger units for purposes, on the fulfilment of which their progress and prosperity must necessarily depend. Even among the hundred and eight States, the rulers of which are members of the Chamber of Princes in their own right, a number are too small to provide adequately for the economic development of their people, and will have to form some sort of federations for the conduct of administrative, and therefore, financial business. These federations may be able to function fairly efficiently as administrative units ; but the smaller States by themselves can neither command the resources nor provide a sufficiently wide basis for the performance of functions, which they, in common with other parts of the country, are called upon to undertake for the full development of our national life. If the States are not, for all time, to mean merely the Princes, as they unfortunately do at present, it is in their own interest to form functional combinations and alliances and establish conditions favourable for the progress of their people. The federated unions of these States may continue to exercise wide financial powers, and to be regarded as constituent units in the financial organization of the country as a whole ; but if they cannot join together for common ends, the limits within which they can enjoy financial autonomy will have to be carefully defined, and measures must be adopted for preventing disorganization of the national financial system owing to any ill-considered action on their part. It will be admitted that no State, whose annual revenue is less than Rs. 50 lacs, can, generally speaking, be administered on a progressive basis and equipped with all the necessary requisites of an autonomous area. The number of States, whose revenue exceeds Rs. 50 lacs a year, is less than twenty ; and therefore all Indian States but these must either be content with limited financial authority or must form functional

unions for the performance of important duties connected with the exercise of their financial powers. A revenue of only Rs. 50 lacs a year is, indeed, not adequate for the progressive development of State functions; but, under the existing circumstances, it will probably be necessary to assign to the States, which have an annual revenue of Rs. 50 lacs or more, the status of fully autonomous units; though even in the case of some of these, union with other States for specific purposes will be highly desirable from the national as well as from their own standpoints. The essential point is that reclassification of the Indian States for functional purposes is necessary. A very large number of them cannot be given an independent financial or administrative position. Their rulers may continue to enjoy all the titles and honours which they cherish so much; but, for administrative purposes, they must resign themselves to be the adjuncts of some bigger areas, either States or Provinces. The States, which occupy an intermediate position between these and about twenty really big States on the top, will have to form some kind of federal unions for the satisfaction of their common needs. The States, which can, with some reservations, be regarded as big enough to function as self-contained units, will enjoy wide financial authority, the use of which will be subject only to those restrictions which are necessary in order to ensure national unity. Even the most casual student of Indian affairs will have to admit that the question of the financial relations between the Indian States and British India cannot be handled properly without making discriminations such as these, based on the necessity of securing the ends of efficiency and harmony. This is an elementary fact of the present situation, which cannot be explained away or obscured by any amount of reasoning about legal principles and inherent rights.

The creation of suitable political machinery for joint deliberation between British India and the Indian States, and the reorganization of the latter for the purposes referred to above, will, of course, necessitate the appointment of a special commission. It will have to make a sifting enquiry into the actual and potential resources of

the States, their stages of development, and other relevant features, examined from the point of view of the possibilities of association for functional purposes; and when a basis for the reorganization of the States has been decided upon, it will be necessary to devise means by which the autonomous and associated States can take part in the common counsels of the nation. Once the need of taking a practical, as distinguished from the legal or constitutional, standpoint is properly appreciated, it will be possible, given the necessary good will, to find a basis for agreement and joint action. The Standing Committee of the Chamber of Princes, at its meeting held in Bombay in March 1928, has already passed unanimously a resolution, in which 'the dependence of the progress of British India and the States alike upon the creation of constitutional means for the adjustment of relations between them' has been duly emphasized. This is more important than all that is being said regarding the States maintaining direct relations with the British Crown, and recognizing its paramountcy rather than that of the Government of India. A glance at the map of India will show that the Indian States form an almost continuous chain of landlocked territories down the spine of India. This is, of course, due to historical circumstances; but it is a fact which will make it possible for the States to associate with one another conveniently for objects of common interest and importance and form functional unions, on account of the geographical continuity of their territories. All such plans for associative action primarily affect the States themselves, and will have to be prepared by them in consultation with one another, though they cannot be put into operation without the concurrence of the people of British India. This, of course, presupposes a radical change in the angle of vision of the Princes, and their preparedness to abandon the proprietary conception of their rule. But this change has to come; and its introduction, with a view to find a basis for the financial settlement, will facilitate 'the creation of constitutional means for the adjustment of relations' between British India and the States. In the resolution referred to above, the Standing Committee of

the Chamber of Princes also declared 'its resolve to devote to the material and moral progress ot the subjects of the States any advantages resulting from an equitable adjustment of fiscal and economic issues'. This amounts to a willingness on the part of the Princes to agree to these adjustments being made on the assumption that the interests of the people of the States will receive adequate attention at their hands; and they would be prepared to adopt measures calculated, to quote from the Bombay resolution once more, 'to promote the welfare and good government of their subjects.' Association of the States for the discharge of specific functions is necessary for the welfare and good government of the subjects of the States, and ought to be brought about with that end in view. Without such unions, many States will be quite unable to raise the standard of efficiency of their administration to the national minimum. The bigger States will also do well, as stated above, to associate with one another for definite purposes, even if they do not form or join any permanent union.

The question has never been studied from this point of view, and will have to be carefully investigated by a special commission. It is, therefore, not possible to indicate more precisely the lines on which the solution of the problem ought to be sought or is likely to be found. But some of the important financial issues, which will have to be considered in this connexion, may be briefly dealt with in a very general way. Their treatment will not only be brief, but also sketchy, the purpose in view being not to make definite suggestions as to how the settlement ought to be made, but to indicate the attitude which has to be adopted in dealing with these questions.

The first question, which has to be considered, is the question of the tributes paid by the Indian States. The revenue derived from this source is credited to the account of the Government of India; and it represents contributions paid by the States, in several cases, as a result of exchanges of territories and settlement of claims, and also payments, chiefly in lieu of former obligations to supply or maintain troops. The total sum of these tributes amounts to about Rs. 80 lacs. They vary from

Rs. 100 in the case of a small State in Assam—Ramrai—to Rs. 24½ lacs in the case of Mysore. The variations in these amounts are due to the military, political or administrative exigencies of the past, and have nothing to do with benefits received by the States or the cost of services rendered by the Government of India. They are the result of a series of historical accidents, and are at present without any rational basis or justification. They cannot be considered as the price of the protection accorded to the States since in their origin and incidence there is an amount of diversity, which makes it impossible to continue them on that assumption. They carry with them, moreover, a taint of the ascendancy of the British Crown and the political abasement of the rulers of the States. Whatever may be the future relations of the Indian States with the British Crown, their relations with the Government of India cannot have any feature, suggestive of the political humiliation of their rulers; and as the tributes cannot possibly change their essential character, they must be abolished so far as the Government of India are concerned. They may have a place in the finances of the Indian Empire, but can have none in those of self-governing India. In any re-adjustment of financial relations between the Government of India and the States, therefore, the very first act must be to make a clean sweep of all tributes and subsidies, paid by the latter to the former. They are the momentos of a past which has to die, and must be buried once and for ever.

The question of national defence is closely connected with that of the tributes, and may next be considered. At present the Paramount Power is responsible for the defence of both British India and the States; and though some of the States bear a part of the cost of defence in various ways, the duty of the Paramount Power to protect the States has nothing to do with these contributions, and has to be discharged, irrespective of any payments by the States. A large number of States are entitled to this protection, according to the terms of their treaties; and to others the same obligation is due, even when there is no express provision in their *sanads* or engagements with

the British Crown. 'The essence of their relationship with the Crown,' as stated in a publication [1] of the Standing Committee of the Chamber of Princes, 'is the guarantee of defence by the Paramount Power.' The right to interfere in the internal affairs of the States is based on this obligation; and it is impossible to maintain this right without discharging this obligation. India can have only one army, for the protection of the whole country; and this includes the duty of protecting the States. This army must, sooner or later, be placed under the control of a Central Government, responsible to the elected Indian Legislature; and as the Viceroy will not be able to use this army without the consent of the Government of India, the guarantee of defence by the Paramount Power will not remain effective, unless the Indian States are assured of the active co-operation of the Government of India in all matters affecting their position or safety. They will, in practice, have to come into intimate contact with the Government of India in all such cases, and to recognize the necessity of making that Government the organ of the national will in this, as in all other matters. The States simply cannot leave the Government of India alone in matters relating to national defence; and the only practicable course for them is to obtain a share in the military administration of the country by virtue of their having a well-recognized place in the national political system. As remarked above, it is impossible to carry on the administration of the country on the assumption that there will be two co-ordinate authorities in India, which may negotiate with each other on a footing of equality, but will, if they fail to reach an agreement, go their own way, and pay no heed to each other. The common policies must be conceived and executed by a Government whose decisions are based on the assent of the whole nation; and the States must be placed in a position to take part in the formulation of those policies, and signify their agreement with them in a manner which may leave no doubt regarding their truly national character.

[1] *The British Crown and the Indian States*, p. 154.

If the above view is accepted as correct, a change in the existing arrangements will be necessary. The States are now maintaining their own troops, and are also responsible for maintaining the Indian State Forces, formerly designated 'Imperial Service Troops'. The strength of the Indian State Forces, according to a Government publication, is 27,030 ; and the strength of the other troops maintained by the States is about 50,000. The Indian State Forces cost the States about Rs. 5 crores; and though the cost of the other troops cannot be ascertained, it cannot be less than Rs. 5 crores. The distribution of the entire cost of maintaining these troops among the States is very haphazard, and is determined by treaties made between the Crown and the States very long ago. The incidence of the cost of defence thus allocated bears no proportion to the population of the States or their resources; and there is nothing to be said for requiring the States to participate in the defence of the country in the way in which they are doing at present. 'The different States', to quote from the publication of the Standing Committee of the Chamber of Princes referred to above, 'came into their present relations with the Crown, or with its predecessor, the Company, in many different ways at many different times. The treaties which bind the States and the Crown reflect the conditions of the times when they were made.'[1] And as the conditions now are entirely different, it is not fair to the States themselves to base these defence arrangements on the terms of the treaties. The sanctity of these treaties has been affirmed by the British Government times out of number, but it is well known that neither their letter nor their spirit has been scrupulously respected in the past; and that is as much due to the fact that they 'reflect the conditions of the times when they were made' as to the exercise of the rights of Paramountcy in an arbitrary manner by the British Crown. In this case again, as in all others, it is necessary to look to the future for guidance, and not to allow the events which determined the terms of these treaties come in the way of future re-adjustments.

[1] *The British Crown and the Indian States*, p. 152

The only satisfactory solution of the problem is to relieve the States altogether of the responsibility for national defence, and make it the exclusive concern of the Government of India. The States should be responsible for the security of the country, only to the extent to which the Provinces are and will remain responsible; and that, of course, means that they will maintain only police forces and rely upon the Government of India for help, when situations of exceptional difficulty have to be faced and render it necessary to adopt emergency measures. The States will also be expected to help the country in times of stress with men and resources, and to place them at the disposal of the national Government. But ordinarily military expenditure will be a charge on the central revenues only, and the States will not be required to make provision for it in their own budgets.

This change will make it necessary to consider afresh the question of the allocation of the cost of defence. The States will presumably be relieved of all the expenditure which they are incurring at present in maintaining the Indian State Forces or their own troops. But some are supposed to be carrying the burden of military expenditure in another form. A number of States have assigned or ceded territories in lieu of their liability for providing troops. Should they receive back the assigned or ceded territories? It is not easy to make a general statement, which will apply to all cases; but, generally speaking, it may be stated that such territorial changes should be avoided. These are annexed territories for all practical purposes; and the question of handing them back to the States cannot even be mooted without raising almost insoluble issues. The wishes of the people concerned will naturally have to be considered; and it may be assumed that the results of the plebiscites will, in most cases, be adverse to the claims of the States. It is, therefore, best to leave things as they are, and not create further complications by proposals of territorial changes. The map of India has been compared to a tessellated pavement, and the Indian States to its *tesserae*. This historical mosaic is already full of elaborate designs, and it is not desirable to make them yet more elaborate

by making territorial re-adjustments. But the question still remains, if the States are to depend upon the national army for defence, and to be relieved of the expenditure which they are incurring at present for military purposes, how are they to contribute to the expenditure incurred for the maintenance of the national army? The answer to this question cannot be given without taking into account other aspects of the financial relations of the Indian States and British India.

Of these, the most important is the question of tariffs. There can be no question as to what is required under the existing circumstances. The whole country has been fused into an economic unity; and it is, therefore, necessary that there should be complete freedom of trade within the country, and a central authority for the regulation of commerce. It is impossible to permit different parts of the country to set up internal tariff barriers, or adopt policies inconsistent with the common tariff policy of the country as a whole. The States have, in the future, as in the past, to fall into line with the national tariff policy; but as it is impossible to secure their adhesion to national policies by the methods which have been so commonly used in the past, it will be necessary in the future to provide for joint deliberation in this, as in all other matters of common interest. This general statement of the situation does not, however, carry us very far; and it is necessary to realize that the application of a common policy has to be carried out in such a way as to provide for arrangements suited to the circumstances of the individual States. That the present situation is very unsatisfactory admits of no doubt or dispute. With the increase in the rates of tariff duties since 1917, and the adoption of a policy of discriminating protection, the States have been made to realize that they cannot afford to remain indifferent to these developments and that they have to safeguard their interests. As a result of the imposition of heavy customs duties by the Government of India, the subjects of the States are being required to carry fiscal burdens which are not in any way related to any principle or policy in which they have had a part, and have to be borne because they are not in a position

to protest against them. These measures have been introduced without any reference to the interests of the States; and in making these important changes of policy and practice, their effects on the well-being of the people of the States or their fiscal systems have not even been considered. The States cannot possibly acquiesce in this state of things, and the legitimacy of their demand that these arrangements should be so modified as to give them an effective share in the determination of our tariff policy has to be admitted. It will be one of the functions of the institution, which may be set up for devising concerted measures in all matters of common interest, to afford opportunities to the States to participate in the determination of our tariff policy. These questions will have to be differently handled, and the haphazard way in which fiscal burdens have been imposed upon the peoples of the States without any regard for their views and interests must become a thing of the past. The place which has to be assigned to the States in the common counsels of the nation, will make it possible for them to influence and have a hand in shaping the country's fiscal policy. The Tariff Board will also have to take into account the interests of the States, in making recommendations on the application of the policy of discriminating protection in particular cases. In the past, the States have had to impose or abolish the cotton excise duty, according to the exigencies of the finances of the Government of India, and the pressure to which the latter were subjected on account of the well-organized agitation carried on by the cotton interests of Lancashire or Bombay. The States will, in the future also, it is true, have to impose or abolish countervailing excise duties according to the changes adopted in the fiscal policy of the country; but it will be possible for them to insist that, in making these changes, the state of their finances, the needs of their industries, and all other related issues shall be fully considered before any decisive action is taken. It may even be necessary to impose some protective duties, primarily in the interests of the industries of the States. Since the economic interests of the States and of British India are identical, the obvious necessity of having

a common tariff policy, based on mutual agreement and regard for the interests of all the constituent parts of the country, has to be accepted as a basic fact of our entire political system.

If it is admitted that the country must have a common tariff policy, and that it should be based on agreement on all matters of principle and also in essential details, there will follow two results, both of them of considerable importance. One is that the States will have to abolish all import and export duties of their own. Now most of the inland States impose their own import and export duties, the only important exception being Mysore. In a number of States, these duties are, next to land revenue, the most important source of income for their exchequers; and, according to the Indian States Committee, in the aggregate the receipts from these duties amount to four and a half crores of rupees. Taking the recent budget figures of some of the most important States, we find that in Hyderabad the customs receipts are Rs. 1·33 crores, in Kashmir 40·25 lacs, in Travancore 30·39 lacs, and in Gwalior Rs. 31·50 lacs. The States, of course, attach great importance to this right to impose tariff duties of their own. It appears to them an essential element in their internal sovereignty, and they are not likely to surrender it easily. But if the reciprocal relations of the Indian States and British India are to be placed on a realistic basis, it is necessary for the former to waive their right to use this symbol, in the interests of the larger fiscal comity of the different parts of the country. There is, however, a more substantial reason against the Indian States forgoing this right of levying their own tariffs; and that is, of course, the fact that very few States can afford to do without the revenue which they derive from this source. This consideration is important, and may prove conclusive against the introduction of a customs union; but if we take into account the fact that, in accordance with the functional integration of our national life, they will be relieved of all the charges that they now incur for the maintenance of troops, they will, in most cases, be able to take effective measures to abolish these duties without causing any

serious embarrassment to themselves. The total sum spent upon military charges by the States amounts, as already stated, to at least Rs. 10 crores; and if to this we add the sum of Rs. 80 lacs, by which the States will increase their resources on account of the remission of the tributes paid by them to the Government of India, they will collectively realize a very considerable net gain if these measures of reform are simultaneously introduced. There will, of course, be cases of individual States, in which the loss may be greater than the gain. In Hyderabad, for example, the expenditure on the army is about Rs. 72 lacs, while the customs receipts amount to Rs. 1·33 crores; and this State will have its revenue diminished, therefore, by Rs. 61 lacs, if it is to abolish its tariff duties and be relieved of its military charges at the same time. In such cases, adjusting assignments may have to be made for the time being, unless some other compensating factors can be brought into operation; but, taking the States as a whole, it may be affirmed once again that the introduction of these two measures will be beneficial for them as well as the country as a whole, and need not give rise to any insuperable difficulties.

This leads us to the next point, which naturally arises if we are to argue the question on the hypothesis that the country is to be a *Zollverein*, and its tariff policy determined by the same authority. The point is that, if the collection of maritime customs is to be centralized, there ought to be a method by which the receipts can be divided as between the Indian States and British India. This again involves the consideration of a related point, namely the contribution to be made by the Indian States to national expenditure. The former point may first be considered. It is not necessary to discuss it on the basis of analogies, drawn from the inter-fiscal relations of landlocked States with foreign States through whose territories their trade has to pass. The Indian States, as remarked above, cannot be foreign States in relation to British India; and, therefore, devices like transit in bond, or leasing of land for building warehouses, etc., must necessarily be ruled out of court. These analogies

are also obviously inapplicable to Indian conditions, if the assumption that India is to be a *Zollverein* is to set limits to the range of our speculations on the point. We are concerned with the question of the division of receipts, and not with that of devising arrangements by which the goods imported into or exported from the States may be granted exemption from British Indian duties. One method, by which they can be allowed to share in the customs revenue, is that the British Indian Government should collect duties on all goods imported into India, at uniform rates, but, on goods of foreign origin consigned specifically to the territories of the States, should grant drawbacks to the States. A similar arrangement will, of course, have to be introduced in the case of goods exported from the States to foreign countries. This system of drawbacks is already in operation for goods imported into the Kashmir State, and can be introduced in the case of other States as well. This arrangement is practicable, but is open to one very serious objection; and that is that, since there will be absolute freedom of internal trade, it will be possible for the States to increase their revenue at the expense of British Indian revenue by building emporiums of trade within their territories, not only for their own people but also for neighbouring British Indian territory. This will lead to unnecessary complications, which ought to be avoided. There are two other methods, which can be suggested for the division of the customs receipts, viz., that they should be distributed among the States either in proportion to their revenues or their expenditure. These two methods should, in the case of States which have introduced the sound budgetary principle of balancing the two sides of the public accounts, yield the same results; but as there are very few States, which have placed their finances on such a budgetary basis, the adoption of these two methods is likely to lead to different results. But it is unnecessary to discuss their relative merits, as there is no reason why the distribution of the customs receipts should bear any proportion either to the revenues of the States or their expenditure. Their financial systems are characterized by such a

diversity of principles and practices that the division of the customs receipts on either of these bases is bound to give rise to all sorts of anomalies.* There is only one other method, which can be suggested for the purpose, namely that the apportionment of the customs revenue should be made according to population. This method is simple; and though exception can be taken to it on the ground that, since the States are at different stages of economic development, their population is no index to their consumption of the dutiable articles, as a rough measure of an equitable distribution of the customs receipts it ought to do, and ought to be accepted on account of its obvious advantages.

The question of the apportionment of the customs receipts must, however, be considered in connexion with the question of the apportionment of expenditure. The States evidently have not only rights but also duties in this matter. If they are to be relieved of all independent liabilities in respect of the maintenance of troops, etc. they should make their due contributions to the national expenditure, that is, the expenditure of the Government of India, on some agreed basis. The Government of India will be the national government, and all functions of national importance will be discharged by them. The States will have a share in their counsels, and be benefited by their activities. They have, of course, special obligations in matters relating to national defence, and their liability to bear a part of the expenditure upon it cannot be disputed. The total military expenditure of India is about 55 crores; and the only way in which the States' share of this national burden can be fairly assessed is to adopt the population basis. Revenue, expenditure and area, three other bases which may be suggested for the purpose, are, it need scarcely be stated, much less satisfactory; and a *per capita* assessment is, therefore, likely to be accepted as fair and equitable for all concerned. But the obligation of the States to contribute to the expenditure of the Government of India cannot be discharged, merely by assuming a liability for part of the military expenditure on a population basis. The expenditure incurred by the Government of India on civil

administration, currency and mints, and interest charges on unproductive debt, is also common expenditure ; and the States should, in fairness, be considered liable to pay their quota towards it. It may be possible to suggest some complicated method by which the States' share of this common expenditure can be assessed ; but probably the best method of squaring accounts is to treat the payments which the States have necessarily to make under customs, salt, railways, currency and mints as their contributions to the national expenditure. The problem of enunciating principles of financial re-adjustment will thereby solve itself ; and as the States will not be called upon to make any other contributions, they can devote their existing resources to the material and moral progress of their own people, and develop these resources further, with a view to provide for them all the amenities of a progressive administration. The Standing Committee of the Chamber of Princes, in the publication which has been referred to above, has tentatively estimated the contributions of the States at about Rs. 10 crores.[1] Assuming that this is a correct estimate, it cannot be said that the States' contribution to the common charges is in any way excessive, if they are exempted from the liability of making any other payments.[2] The settlement of financial issues between British India and the Indian States, though based on equity, must be determined by general considerations ; and if the States want a square deal, they may, if they so choose, have an expert enquiry made, to work out more exact principles of adjustment. The

[1] *The British Crown and the Indian States*, p. 213.

[2] The total expenditure of the Government of India, excluding the direct demands on revenue, i.e., the expenditure of the revenue-collecting departments, and railway interest, amounts, roughly speaking, to Rs. 95 crores. As the population of the States is 22·5 per cent of the total population of India, the States' share of this amount on a *per capita* basis will amount to over Rs. 21 crores. It is not contended that the States ought to pay this amount to the Government of India ; but it is obvious that, if the existing contribution of the States is Rs. 10 crores, and it can be assumed that they have no other obligations, they need not have any grievance on the ground of having to make this contribution.

results of such an enquiry, however, will probably show that, though there may be more intricate methods of adjusting these claims and counter-claims, the ends of justice and fair dealing can be best achieved by taking it for granted that the debit and credit entries offset each other; and while admitting the necessity of further adjustments in individual cases, the States, on the whole, it can be safely assumed, will not lose much if they agree to the settlement being made on this simple basis.

This, it is needless to add, is a suggestion whose value is limited on account of the utter inadequacy of the data on which it is based. It is necessary to go into the question very thoroughly, with the help of much more precise information as to the existing situation, and to find some means of dealing with it from the point of view of bringing the States into close functional association with the Government of India. But if the necessity of adopting a broad-minded view of the matter is conceded, it will appear that the solution of outstanding problems can be considerably facilitated by making the States partners in the receipts and charges of the Government of India in this simple but effective manner. The questions involved are intricate; and if they are to be handled as issues for the settlement of which any scheme of integral federation has to make provision, they cannot be disposed of with any measure of success without formulating definite plans of close and 'co-ordinate' co-operation between the Government of India and the Indian States. It is beyond the scope of this book to attempt an elaboration of any plan of this kind. For the purpose of the argument of this chapter, it is enough to assume that, without suitable arrangements for the initiation and execution of common policies, these questions cannot be settled. But it appears likely that, if the tributes are abolished and the States are relieved of the responsibility of incurring expenditure on defence, the necessary financial adjustments between them and British India can be made without creating any serious complications. What is needed is that the issues should be dealt with in a spirit

of co-operation, based on a clear-sighted vision of our national future.

It has already been suggested that all the indirect payments, which the States make to the exchequer of the Government of India, should be treated as their contributions to the expenditure of the latter. If this view is taken, it becomes unnecessary to discuss the propriety or otherwise of the Government of India taxing the peoples of the States through other indirect taxes or through monopolies like railways and posts and telegraphs. Excise must be a central source of revenue ; and the States ought not to be allowed to have excise duties of their own, or to create difficulties in the way of the successful administration of the central excise duties. It is, therefore, not necessary to consider the question of the share of the Indian States in the receipts of the salt tax or of excise duties. As regards the restrictive excises, which, on account of the peculiar conditions of our fiscal system, are and probably will remain Provincial sources of revenue, it is also not necessary to say much. The major States will continue to have their own excise duties, and there will be a large measure of co-operation between them and the adjoining Provinces. But co-operation, in this as in all other respects, will not mean that the States will be required to acquiesce in the adoption of any policy, or the levy of any rates of duties, which it may suit the Provinces to introduce. Any points of dispute between them will have to be submitted for adjudication by an independent tribunal; and the National Finance Commission will probably be the body for the settlement of such differences and for the co-ordination of policies. The Commission will, as a matter of fact, be charged with the duty of ensuring harmony and adjustment in the fiscal relations of the States and the different parts of British India in just the same way as it will perform that function with regard to the different parts of British India. There will be need for measures taken in common ; and the avoidance of conflict, which till now has been secured by the exercise of paramountcy by the Paramount Power, will have to be provided for, in the years to come, by the arbitration of disputes and by the opportunities

which will be afforded for the adoption of concerted measures.

The management of public utility enterprises by the States in India will give rise to problems of their own so far as the question of re-adjustments between the Indian States and British India is concerned. These are undertakings which should, in the interests of efficiency and the common weal, be constituted into autonomous public service corporations, with their own assets and liabilities. They must be run on sound business lines; but on account of their vital importance to the well-being of the country as a whole, their public service aspect should be duly emphasized in all matters of policy as well as in important details. As the States cannot have independent organizations of their own for these services, they will have to fall into line with the rest of India in all matters relating to them, and subordinate their own interests to the supreme need of providing efficient and well-managed undertakings for the whole country. In fact, there cannot be any conflict of interests between the States and British India in these matters, for any measures which impair the efficiency or integrity of these undertakings will militate as much against the development of the States as they will against that of British India. Railways are a case in point. 'It is clearly necessary in the interests of India as a whole,' to quote from the Indian States Committee Report, 'of the travelling public and of trade that all measures required for the proper working of arterial railways should be concentrated in the hands of one authority'.[1] That this is a correct view of the matter admits of no dispute; but it is necessary to add that the one authority, in whose hands all matters affecting the railways are to be concentrated, should regard it as its duty to direct its policy towards a balanced development of all parts of the country, and lines should be so laid out as to give a stimulus to the internal trade and industries of the States as well as of the rest of India. At present, the States 'feel that the policy of the Railway Board is often inimical

[1] *The Report of the Indian States Committee*, para 9, p. 46.

to their interests, and the decisions of the railway officials carry more weight with Government than the protests of a State which feels itself unfairly treated'.[1] This state of things must come to an end. In the matter of railways, there is, as already remarked, a complete identity of interests between the States and British India; and the authority in charge of their management must place itself in such a position as to command general confidence, and to be above all suspicion. It will not do for the Railway Board to discriminate against the States or any other part of the country. It is impossible for it to detach itself immediately from its past associations, or to establish for itself immediately the reputation of being absolutely fair to all parties. That will take time; but the separation of railway finance from general finance will not yield its full harvest of good results, unless the railways become a national enterprise in the best sense of the word, and are regarded as an organization which can be depended upon for taking initiative, on its own account, in these matters in the highest interests of the country. The States now have 3,000 miles of lines of their own. In the case of branch lines of local importance, they may be allowed to have their own railways; otherwise, it is in their own interests as well as those of the country as a whole that all lines should be under the same authority, and form part of a unified system. The States have been claiming a share in the contribution paid by railways to general revenues; but that is the least important aspect of the problem of readjustments. What is of far greater importance is that, in the development of railways, their interests and needs should receive as much attention and should be regarded just as important as those of British India In a word, the railways should be run as a truly national enterprise. The same considerations apply to irrigation. The necessity of making provision for inter-provincial co-ordination, in matters relating to irrigation, was pointed out in Chapter VI; and it was also stated that the Indian States would have to cooperate with the Provinces in the development of these

[1] *The British Crown and the Indian States.*

works. It was suggested that it would be necessary for the Provinces, and in some cases the Provinces and the States, to join hands in the construction of these works, and have a common organization for their administration. In such cases, it is of paramount importance that there should be a central authority for the settlement of differences and the initiation of common policies. The Posts and Telegraphs, of course, fall under the same category. These departments are already being managed on national lines; and though, in a few cases, complications exist because the States have their own post and telegraph systems, and it will be necessary to persuade them to forgo this unimportant right, the unification of this service does not present any serious difficulties. Both Irrigation and Posts and Telegraphs will have to be reorganized and constituted into autonomous undertakings. In the case of the latter, the reform can be easily introduced. But it is not possible to reorganize irrigation without raising some very difficult issues. The States, however, have, it is obvious, a very real interest in all measures relating to the functions and future of the irrigation system, and ought to be closely associated with the administration. They should have the opportunity of influencing all policies and projects, whether for the reorganization or developments of the systems.

The States will have wider fiscal powers than the Provinces. It will be difficult to devise any arrangement for the distribution of assignments or subsidies to the States from the central exchequer. In some cases, re-adjustments will be facilitated by the grant of compensating assignments to the States, but these are payments of a different order; and, as a rule, it may be assumed that the States will have to depend upon the revenues collected by themselves to a much a greater extent than the Provinces. It will be necessary, therefore, to let them impose certain taxes, which the Provinces will not be permitted to levy for their own purposes. The most important among them is income-tax. A number of States have already introduced their own income-tax; and it is desirable that all the major States should make use of this important fiscal and social machine. The

income-tax of British India has been recently modernized; and the States will do well to take it as a model, and assimilate their own income-tax laws to its provisions. But, in any case, the conflict of jurisdictions and evils of multiple taxation will have to be provided against. Most of the States, which have their own income-tax, have already accepted a working compromise by which relief is granted to assessees, who are liable to being taxed both by British India and the States on account of the origin of the income and the domicile of the tax-payer being located in different tax-jurisdictions; and the cost of relief is equally shared between the two authorities. This seems to be a fair arrangement; but it is possible that, in certain cases, it may not be equitable to the parties owing to the cost of relief falling on only one of them; and it may be necessary to adopt other measures for avoiding double taxation. That, however, is a matter of detail; the essential point is that adequate provision should be made for harmony in the fiscal inter-relations between British India and the Indian States. It will be the duty of the National Finance Commission to keep a careful watch on the working of the income-tax laws of both in order that the economic unity of the country, as a whole, may not be weakened by any inordinate zeal on the part of their revenue officers to promote the fiscal interests of their respective governments. The States will, of course, also have their own death-duties. A number of them are in advance of British India in this respect; but, generally speaking, it may be stated that, in the States as in British India, the social significance of death-duties and their fiscal possibilities have still to be realized. The States will, when they introduce and develop these taxes, have to keep in view the importance of uniformity of principles in all matters affecting the inheritance laws, and avoid all unnecessary complications. They will be well-advised in working in close co-operation with British India in the administration of this measure; and it will, of course, be necessary to provide safeguards against multiple taxation. It will probably be desirable for them to adopt the convention, suggested in Chapter

VI, for avoiding inter-Provincial difficulties in the apportionment of receipts, and let realty be taxed where it is situated, and personalty where the deceased was domiciled. The States may develop some other direct taxes as well, and their administration will also give rise to problems of co-ordination. It is a matter for regret that, in the assessment and collection of income-tax, death duties, and other direct taxes, it is not possible to have a completely centralized administration. But if the necessity of avoiding multiple taxes is appreciated, and steps are taken to establish fiscal unity in such cases, the worst evils of decentralized administration will not arise, and the fiscal systems both of British India and the States will work fairly well.

The States may not receive assignments or subsidies from the Government of India ; but the payment of subventions to them may be desirable, and even necessary, in some cases. The Road Development Committee has emphasized the necessity of including the States in any scheme of road development that may be adopted, and has recommended the grant of subsidies to them out of the Road Development Fund. The Government of India, in their resolution on the subject, have accepted this recommendation of the Committee, and propose to administer themselves the balance of the receipts of the enhanced import and excise duties on motor spirit, due to the consumption of petrol in the minor Provinces and the Indian States. This amount and part of the reserve of ten per cent which the Government of India are going to retain in their own hands, are to be utilized for the development of roads in these areas ; and the States will, therefore, practically receive grants from the Government of India for the improvement and construction of roads in their territories. This is good as far as it goes ; but it will be necessary to provide for the distribution of grants to them for a number of other purposes as well, and the fund for the payment of subventions, which, as was suggested in Chapter VII, should be an integral part of the future system of federal finance in India, will be drawn upon for accelerating and synchronizing the pace of progress in

certain specified directions in the Indian States as much as in the Provinces. There will, of course, be an all-India plan for the development of such functions, and the Provinces and States will be expected to adhere to it; but this plan will be a co-operative enterprise, and the element of superintendence, direction and control will be reduced to the minimum. Subventions will secure integration, but not centralization; and though it may be difficult to distinguish between the two in actual practice, the distinction between them is, as remarked already, real and important, and can be made operative in the working of our political system. The distribution of subventions among the States will be necessary in order to enable them to work up to the national minimum in the administration of certain vital services.

India can have only one currency system. Multiplicity of currencies will undermine her economic unity and make currency control, which is nowadays considered essential for all well-organized systems of credit and currency, ineffective, if not impossible. All the States enjoy, in theory, the right to have their own mints, but almost all of them have already closed their mints; and though some States are still exercising the right of issuing their own coins, and Hyderabad has even its own paper currency system, the unification of currencies in India is all but complete. It is necessary to carry the process further by persuading the States, which have not as yet closed their mints, to do so in the interests of the efficiency and integrity of our national currency system, and to depend upon the central currency authority for the supply of currency for their own requirements. The central currency authority now is the Government of India; but if the Reserve Bank is established, and is placed in a position to discharge the functions of a fully-developed central bank, it will become the highest currency authority of the country, and though it will work in close co-operation with the Government of India, it will be independent of the latter and be constituted into a national trust. The States have grievances against the Government of India on account of their having disturbed the stability of prices by the manipulation

of currency and exchange. They also feel that the appropriation by the Government of India of profits accruing to the Gold Standard Reserve, owing to the divergence between the intrinsic and face value of the rupee, and of the income derived from the invested portion of the paper currency reserve, involve indirect taxation of their subjects, and they feel that they ought to have a share in these receipts of the Government of India. The fluctuations of prices and of exchange in the past have had a disturbing effect on the economic life of the whole country; but all these fluctuations have not been due to currency manipulations, and it is impossible to suggest any rational basis for the apportionment of the income accruing to the Government of India from the investments of the Gold Standard and Paper Currency Reserves as between the Indian States and British India. The banking enquiry, lately undertaken by the Government, ought to provide the necessary material for introducing comprehensive legislation for the creation of a unified system of credit and currency, the management of which should be entrusted to an independent and autonomous body like a properly constituted Reserve Bank. That institution will occupy a position of detachment from the ordinary financial preoccupations of the Government of India, and may be expected to conduct its activities with a due regard for the interests of the whole community. The interests of the States will be quite safe in its hands; and they will only be injuring themselves and the country as well, if they insist on exercising their undoubted constitutional right of introducing their own systems of coinage and currency. For the efficient working of every currency system, unity of command is absolutely necessary under present conditions; and there is also a consensus of opinion among the most advanced writers and thinkers on currency problems that this condition can best be fulfilled by establishing an institution of high repute, and investing it with wide and effective powers of control over all other banking institutions. In currency matters, the world has come to a stage at which international co-ordination and control have become inevitable; and at a time when

the Bank of International Payments, which has been established, promises to develop into a Central Bank of Central Banks, it is too late in the day to discuss seriously the possibility of the Indian States having their own independent currency systems. It is necessary, as suggested above, that the States, which at present have mints of their own, should withdraw from the field of coinage. For the success of currency reform in India, the dethronement of the rupee is almost as important as the establishment of a Central Bank; and if the States continue to issue standard silver coins of their own, they will render the task of carrying out this urgent measure of currency reform more difficult than it need otherwise be. The States, to repeat, can gain nothing by clinging to this shadowy attribute of political sovereignty.

The financial administration of the Indian States is, it is well known, extremely backward; and it is in the interests of the States themselves to reorganize it. As it is, only 56 States have a fixed privy purse; and, even among them, very few have anything like a regular budget or disbursement of funds in accordance with any scheme of appropriations. Practically, there is no system of audit worth the name; and public accounts are maintained in a manner which makes it difficult to exercise control over public expenditure. In States, in which there is no distinction between the public and the privy purse, the conditions are, of course, much worse, and the management of public finances is in a state of incredible confusion. Waste and misappropriation of public funds are exceedingly common; and the conditions of financial administration are as archaic as are those of the general administration of most of these States; the state of their finances cannot bear comparison even with that of some of the worst administered South American States. We cannot have anything like a satisfactory system of federal finance in India, if this state of anarchy continues to prevail in the financial administration of the Indian States. They must set their house in order, and introduce some method in the management of their public purse. A fixed privy purse should be the

rule and not the exception in all States which are to enjoy fiscal autonomy; and their finances should be administered in accordance with what are called canons of financial propriety. There ought to be a system of efficient and independent audit of public accounts; and the latter should be maintained according to well-accepted principles of account keeping. It is not easy to say how these pre-eminently desirable measures of reform can be introduced. Their introduction will probably have to be made a part of the financial settlement, and the National Finance Commission will be charged with the duty of watching how they work in actual practice.. Financial re-adjustments between British India and the Indian States cannot be satisfactory, unless the latter carry on their financial operations according to principles consistent with the business-like and beneficent conduct of public affairs.

The standard of expenditure in the Indian States is very low. If we take the total revenue of the States, and assume that the whole of it is spent for public purposes, we get an average of about Rs. 6·6 *per capita*, which is higher than the average *per capita* expenditure of all Provinces except Burma and Bombay. But the assumption that the whole revenue of the States is expended for purposes, which can be called public in the real sense of the word, is, as every one knows, by no means warranted by the facts of the case; and though some of the States are in advance of the Provinces, in respect of expenditure on important developmental functions, the States collectively are far behind them in what they do for the material and moral progress of their people. The reforms referred to in the preceding paragraph must, of course, be the first step in the direction of raising the level of public expenditure in the States. Improvement in the efficiency of their financial administration will make it possible for them to utilize their existing resources to much better advantage, and to find funds for purposes for which money is not available now owing to the disorderly conduct of their financial business. But even if the States turn their present revenues to better account by adopting sound principles

of financial administration, it will not be possible for them to raise their expenditure to that level which ought to be attained by all the constituent units of the Commonwealth of India. They will have to levy additional taxation for the purpose. The choice of taxes and their rates must be determined by the States themselves; but it should be possible for the National Finance Commission to keep itself informed of all developments in the finances of the States, and make its knowledge and experience available for the use of those, which are looking for new sources of revenues, and wish to have the benefit of its advice and guidance. The Commission should also be in a position to take the initiative, and offer advice of its own accord in cases when it feels that those who are at the helm of the States' affairs need some outside stimulus for quickening the sense of their responsibility towards their people. The weight which this advice will carry will depend upon its intrinsic worth and the position which the Commission can acquire for itself in our national economy. The importance of the latter factor will, of course, be determined by the efficiency and dignity with which the Commission discharges its duties.

This chapter may now be concluded. It is only necessary to add that, in making a financial settlement with the States, the individual circumstances of each State will have to be considered. The settlement will be based on certain fundamental principles. These will have to be agreed upon. In them will also be implicit the limits within which they will have to be elaborated. But special adjustments will be necessary; and their scope and nature will be defined by the circumstances peculiar to each State. The Indian States Committee have recommended that an expert body should be appointed to enquire into (1) the reasonable claims of the States or a group of States to a share in the customs revenue, and (2) the adequacy of their contributions to imperial burdens. This expert body will need some guiding principles for proceeding with their work, with regard to which preliminary agreement will be necessary; and they cannot give their opinion even on these points without

bringing under review the whole field of the financial relations of the States with British India. The terms of reference of this body of experts must be very wide and so enable it to make recommendations, which may be the basis of a comprehensive financial settlement. This body will, in the words of the Indian States Committee, have to break much new ground. The whole field of enquiry is, as a matter of fact, absolutely virgin soil, and needs to be cultivated with very great care and ability. The nebulous character of the suggestions contained in this chapter is, it is needless to say, due to the fact that speculations about a region, which is practically unexplored, cannot but be extremely vague and hypothetical. They are, as has been explicitly stated, intended to present a point of view, and are not to be taken even as an outline of any scheme of financial settlement.

## CHAPTER X

### *Conclusion*

Now all the important problems of federal finance have been dealt with. It is not easy to discuss questions of financial re-adjustments without making some assumptions regarding constitutional readjustments ; for the former are an incident of the latter. This book has been written in advance of the constitutional proposals of the Statutory Commission or the developments to which they may lead. But in spite of the limitations under which the work of suggesting possible lines of financial development has been undertaken, the utility of the proposals made in this book is to be judged by the conception of our political future underlying them and of the changes, which have to be introduced, in order to realize it. We have, to repeat what was said in the first chapter, to liquidate the past and anticipate the future. Our scheme of federal finance must be related to the existing facts ; but it must also be regarded as the first step in the evolution of a system in keeping with tendencies, which are of great potential importance from the point of view of the future. The scheme sketched out in the preceding chapters is based on a conception of federalism, which is new. This new conception has still to crystallize itself into a dogma ; but it is clearly visible above the intellectual horizon, and its general features have been grasped by some of the most advanced thinkers and statesmen well enough to make it possible for them to incorporate them in the new federal constitutions. We, in India, have also to make it the basis of the new constitution ; and the qualifying word integral, which has already been used for it, gives us a fairly good counter of thought for assessing its value and realizing its importance. It will enable us, if we understand its full implications, to clear away a number of intellectual cobwebs and to remove certain difficulties which may at first sight appear formidable, but are really

due to our inability to get at the bedrock of facts. As the object of this book is to elucidate essential principles, the details of the scheme are of importance only for the purpose of illustration; and as the whole question must be investigated by an expert body, it is not necessary to lay undue emphasis upon them. But it is important to remember that the conception of integral federalism makes it necessary for us to discuss the problems of constitutional and, therefore, of financial re-adjustments from a different standpoint than those which are ordinarily adopted in the discussion of these questions. H. G. Wells, in one of his recent books, in which he explains the necessity and possible emergence of a new world order, refers to India's place in the economy of things, and makes a statement which is only partially true. He says that, while Japan has changed and is ready to take its place in the comity of nations, India still remains a world in itself.[1] India is not industrialized to the extent to which Japan is; and the magnitude and complexity of her national problems have to be duly appreciated if we want to rise to the height of the occasion. But it will not do to assume that world factors are of no importance in relation to India. In the ordinary sense, this inference is obviously not correct. India has already been drawn into the vortex of the world's affairs, and has to readjust her national life to the changed situation. This is generally admitted; and it is not necessary to labour this point. But, even in the sense in which H. G. Wells makes this statement, it is not right to say that India is unaffected by those intimations, incipient tendencies and new stirrings which contain, according to him, the promise of a new and brighter day in the life of mankind. As was stated in the opening paragraph of this book, India's freedom is to be conceived as part of the world process. The Open Conspiracy, which H. G. Wells believes in, is a world phenomenon, and is not confined to the countries of Europe and America. The necessity of making adequate provision for the future, which has been

[1] H. G. Wells: *The Open Conspiracy*, p. 87.

stressed already, arises on account of the fact that India cannot keep out of this Open Conspiracy. The movement, it is true, has still to be organized and articulated. In India, as in other countries, the number of those who are consciously working for it is exceedingly small; but there are unmistakable signs of the insurgence of the new tendencies in our country, and we have to proceed with the work of national reconstruction with full understanding of the nature and scope of these forces.

The bearing of these anticipations on the problem of federal finance in India has already been explained. The new constitution will not carry us very far. If it can give us a lay-out plan of the structure that has to be erected, and also the freedom to raise it according to our ability and resources, it will give us all that we need or have a right to expect from it. The work of building up will have to be done by ourselves; and one of the tasks, which will have be taken in hand first, is that of Provincial re-distribution. The country must be divided into organic unities. This is necessary in order to find a truly federal basis for our political life; but urgent as the task is, its accomplishment will take time. The future is very obscure, and we can only make tentative arrangements. The fiscal resources ot the country are, it is clear, quite inadequate, and we have to develop them further in order to accelerate the pace of our national progress. This too will take time, and, what is more, the allocation of these resources cannot be made on a basis which will make it possible for each political authority to be an entirely self-contained unit. The integration of economic life, and the consequent difficulty of tracing income to its source, have rendered it necessary to assign the function of the administration and collection of the most important sources of revenue to the Central Government. They have to undertake it in order to promote efficiency and avoid conflict of principles and evasion of taxes. But as they will not be able to spend usefully all the revenues, collected by them, for the functions for which they will be responsible, we shall have to provide for the transfer of funds from the Government of India to the Provinces, for the discharge of the important functions

which will be assigned to the latter. The payment of assignments, subsidies and subventions is to be the method by which the Provinces are to be placed in funds. This is the method by which similar difficulties have been got over in other federal States; but it is essentially an experimental measure and its technique has still to be developed. There are, however, two obvious dangers of using this method, which have to be guarded against. One is the danger of centralization; and the other is that of undermining the self-reliance of the Provinces. Both dangers are real; and the ability and skill of the architects of the new order will be gauged by the measure of success which they achieve in providing the necessary safeguards. Since they have no precedents to go upon, they will have to establish their own precedents; but for that it will be necessary that they should experiment freely, and be able easily to rectify their own mistakes. It is worth while repeating that, in view of these facts, it will be a real misfortune if we commit ourselves to any permanent financial settlement. We have to learn by experience; and we cannot do so, unless we retain the liberty to apply the lessons of experience to the development of our system of federal finance.

The efficiency of this financial system will depend, to no small extent, upon the provision of suitable institutions for integration. A number of such institutions have been referred to in the preceding chapters. The system of independent audit, the National Loans Council, the Railway Board, the Central Bank, the functional unions of the Indian States, and the various *ad hoc* bodies which will have to be constituted for the administration of the subvention funds, will make it possible to provide both for co-ordination and autonomy. These organizations will be national in their aims and the range of their activities, but will not be under the administrative control of the Government of India. They will not be run on the 'civil service' model, or acquire the rigidity of a bureaucratic system of administration. It will be necessary to take steps against the setting in of dry-rot or the subtle working of tendencies which may sap the vitality of these self-governing institutions. This will again necessitate

re-adjustments in the future, and it should be possible to make them without dislocating our political life. The whole system should bear its transitional character on its face; and should be considered a grand experiment in establishing new institutions for discharging new functions.

If the flexibility of the system of federal finance is to be secured, it is necessary that the financial settlement should be taken out of the constitution and provided for by a separate measure. It will be remembered that in Germany, where the whole system of federal finance was radically altered in 1919, the financial relations of the Reich and the States are governed by two measures, which are not a part of the new constitution, and can be modified without any difficulty. It will be wrong to make our political constitution rigid. It is impossible to carry out the task of political reorganization at a stroke; and the constitution will have to be amended frequently, and even radically, if we are to avoid deadlocks in its working. But the conditions, under which the financial settlement is put into operation, must be such as to keep it absolutely plastic, or its breakdown will almost be inevitable. We shall also need our Law of the Financial Settlement. Its provisions will, of course, be determined by the principles upon which our political system will be based. There cannot be a variance in essentials between our political and financial systems. But the Law of the Financial Settlement will have to be revised oftener; and it will be necessary sometimes to make financial changes without changing the Law itself. In other words, the Settlement will be evolutionary, and progressive in response to the stress of circumstances. It will embody the principles of integral federalism, and its development will proceed on lines which will involve their further elaboration in actual practice. But this new conception has still to pass through the stage of formulation, and will not inhibit the growth of the financial system in any way. It is necessary, therefore, to incorporate the financial re-adjustments in a separate measure, and to frame it with a view to facilitate the further development of the system without the adoption of any drastic methods or measures. The Law of the Financial Settlement must

be comprehensive in its scope and designed with a view to providing correctives against its own aberrations.

This measure will have to be administered by a body which has been referred to in several places—the National Finance Commission. Broadly speaking, it can be said that the Commission will be the organ through which the efficiency and integrity of the system will be ensured. The functions which it will undertake have been mentioned already. Its most important function will be, of course, that it will keep a vigilant watch over the working of the system as a whole and prevent the intrusion of disturbing factors. For this, the Commission will have to know what is happening in the domain of finance all over the country. It ought to get the annual reports on the administration of the finances of the Government of India, of the Provinces, of the Indian States, and even of all local bodies. The various Governments will be autonomous within the sphere of their own activities; but as the fiscal system of the country is to have a common framework, and will be based on the same principles, it will be necessary for the Commission to know the principles and important details of the financial policies of all the public authorities in the country. The occasions on which it will be called upon to intervene in the financial administration of these Governments will be very rare; but when it finds that the adoption of particular policies or measures is against the spirit of the Law of the Financial Settlement, it will have the power to invite the attention of the Government concerned to the undesirable effects of its action, and, in extreme cases, even stay the execution of policies pending further enquiry. In most cases publicity will be an effective remedy of financial ills, though it is not inconceivable that cases may arise, in which radical measures may have to be adopted to restore the equilibrium of the system of federal finance. The Commission will also be a tribunal of appeal in all disputed cases, which will be submitted to it for its arbitration or decision. Conflict of fiscal jurisdictions will have to be prevented by making a proper allocation of resources, but even then overlapping of fiscal spheres

is likely in certain cases; and it will be the duty of the Commission to enquire into cases of multiple taxation, and enunciate principles by which the cause of conflict may be removed and justice done to the tax-payers. It will collect, collate and publish data relating to the fiscal activities of the different authorities, and thereby enable the public to form its own conclusions about their character and effects. But the Commission will be something much more than a Bureau of Financial Statistics. It will make use of the information, which it will acquire and publish, as a means of inculcating the lessons of experience and suggesting lines of fresh development. It will remain in constant contact with the Treasuries of the various Governments, and bring to their notice the shortcomings of the systems which they administer, and stimulate them to pursue a more progressive policy in cases where they may be afraid of taking risks on account of their limited horizon. It will be a special duty of the Commission to watch the working of the fiscal systems of these Provinces, which receive special assignments from the central exchequer on account of their comparative backwardness; and it must be in a position to bear testimony to their having done their best to help themselves. All fiscal measures have non-fiscal effects; and it is necessary to study the effects of these measures, and understand how they react on economic and social life, in general. All direct and indirect taxes set into motion forces, which are ordinarily left out of account by those who impose or administer them. The Commission will survey the entire economic life of the community, and enquire into the effects of the working of all fiscal measures. These effects do not become unimportant, merely because they are unseen. Their importance, in fact, not seldom, varies in inverse ratio to the degree to which they can force themselves on the public attention. In the working of tariffs, the Commission will perform some of the functions which the Fiscal Commission expected the Tariff Board to undertake. The Tariff Board now investigates the cases of individual industries. But there are a number of other important functions, connected with the administration

of tariffs, which need to be performed Tariffs have to be overhauled, the inter-relations of different protected industries studied, the effects of revenue duties on the growth of industries ascertained and regulated; and the international aspects of our tariff policies, and the effect of the tariff policies of other States on our economic interests, make in themselves an object of careful enquiry. The working of our tariffs presents a very wide field, which, on account of the peculiar position of the Indian States in our political system, is of special importance. But this is only an illustration of what the National Finance Commission will have to do in order to establish fiscal harmony, and find out the true economic cost of taxation, which, of course, cannot be measured merely by the amount of its yield. These enquiries will be instituted with the practical object of increasing the symmetry and effectiveness of our fiscal institutions. The National Finance Commission, if it is properly constituted, will be able to demonstrate its utility and importance as an organ of financial integration soon after the inauguration of the new financial system; for, if the latter is made provisional, there will be many unsettled questions of policy and practice which will have to be solved in the light of later experience, and many more will arise when the system gets into a good working order. The Commission should, in due course, become one of the most important institutions in our entire political organization.

The question of the composition of the Commission, if it is to occupy a position of such importance and responsibility, is naturally worthy of serious consideration. It is not possible to make any precise statement about the method in which this body should be constituted, or the qualifications of those eligible for appointment to it. There is, however, one general statement which can be made about the relations of the Commission to the Government of India; and that is, that though it will work in close co-operation with the Finance Department of the latter, it will be an autonomous organization, and occupy a position analogous to that which is nowadays considered desirable for an institution like a Central Bank. In other words, it may be said that it

will be independent of official control. The Commission will be a body of responsible Commissioners; but to say this, is to say very little, for the whole difficulty arises on account of our inability to fix upon any authority to whom this body of Commissioners may be made responsible, if they are to be independent of the Government of India. The difficulty is real, and inherent in the facts of the case; but it is not peculiar to the question of constituting the National Finance Commission. It has to be faced in all cases of public institutions in which we have to find a way out of the dilemma of avoiding both popular and official control. The number of such institutions is increasing everywhere; and this indeed is one of the most hopeful developments of recent years. The public control which they exercise over economic and social policies, is constantly increasing; and one of the most important problems of the age is to discover the method or methods by which these institutions can best be constituted and managed. The ideal solution of the problem has not been found as yet; and it is almost certain that it will not be easy to find it. The difficulty of outlining the constitution of the National Finance Commission cannot, therefore, be easily got over. The nomination by the Government of men of high standing and requisite ability will probably be the method with which we shall have to make a beginning; and we must supplement or modify it later, when experience of the working of similar institutions in India and other countries points to the way in which their constitution can be improved. But the Commission once constituted, will; have to be, to quote the words which the Liberal Industrial Enquiry Committee use for the Economic General Staff in their Report, 'clothed with great prestige and placed at the centre of administration.' Its members may be nominated by the Government; but they will not be fit for this position of trust in the national life unless they are men of sterling worth and undoubted originality and independence. They should be men, who are accustomed to take a wide and long view of affairs, and can bring to the discharge of their duties trained judgment, and what is called scientific imagination. They ought to be

familiar with the mysteries of finance and be gifted with a vivid appreciation of the intricacies of the issues with which they will be called upon to deal; but it is obvious that mere financiers and financial experts will not do for this onerous work. The Commission will have to work a system, which will be provisional in all essentials, and will itself have to be constituted by methods and work under circumstances, which will make it also an experiment in the transaction of public business and the development of the technique of public control. We shall have to embark upon a great adventure in taking the work of national reconstruction—and financial reconstruction will only be a part thereof—seriously in hand. Our policy in all matters must be one of constructive opportunism. We are living in an age of discovery and must give due importance to empirical considerations. It is scarcely necessary to add that the Commission will be assisted by a competent and highly qualified Secretariat in the performance of its functions.

The system of federal finance has to grow from within; and once the system has been put into operation, the onus for change must mainly rest on the National Finance Commission. It will not be practicable to have fresh legislation every time that a re-adjustment is necessary; for, as Mr. G. D. H. Cole has remarked in his *The Next Ten Years in British Social and Economic Policy*: 'Whereas legislation, owing to the exigencies of parliamentary business, can take only one step at a time, administration can take many.' 'The individual steps,' he adds, 'may be smaller, but their cumulative effect is far more considerable.' [1] We shall have to create conditions for the progressive development of the new system; and the only way in which this can be done is to arm the Commission with powers wide enough to carry through the task of financial reconstruction. This means that it is not to be merely an advisory body, because 'an advisory department is,' in the words of the Liberal Industrial Inquiry Committee Report, 'always in

[1] G. D. H. Cole: *The Next Ten Years in British Social and Economic Policy*, p. 153.

danger of being frozen out and be handed all the problems to the examination of which it is politic to give some measure of lip service but which do not really matter '.[1] It will be one of the most important functions of the Commission to conduct enquiries into current financial questions, affecting the development of the system of federal finance, and to co-ordinate and, where necessary, compile statistical information required by the public and the Legislature. Publicity will be one of the most powerful weapons by which it will invite the attention of the nation to the flaws in our financial system, and arouse it to the necessity of taking effective measures for their removal. But the Commission must not, on any account, be permitted to become merely 'an academic body drafting endless memoranda, probably excellent memoranda, which nobody reads'.[2] The Commission is to be an organ of national life; and if it becomes merely a glorified Department of Financial Research, it will deserve a very high place in the list of successful parodies in the art of nation-building. If the Commission is to be a reality, it must, it may be stated again, have wide powers and exercise initiative and foresight. It is to administer the Law of the Financial Settlement; that is to say, it has to work the new system according to the spirit of the Law, and make whatever changes may be necessary to realize the purposes implicit in it. It must be essentially a committee of action—a body which may fulfil 'the need of constructive thought in advance of executive decisions'; but it can fulfil itself only by creative activity in the field of financial reconstruction. As an organ of integration, it must be 'clothed with great prestige and placed at the centre of administration'—of course, the financial administration.

Mr. Alfred Zimmern who, it may be said in passing, is one of those adventurous spirits, who are doing pioneer work in the discovery of the New World, and is, therefore, an effective member of the Open Conspiracy, of which H. G. Wells is the herald, in one of his

[1] *Britain's Industrial Future*, p. 118.
[2] Ibid.

essays in the *Prospects of Democracy*, makes a simple but profoundly true statement. He says: 'Politics were made for men and women, and not men and women for politics.' This statement sounds like a truism; but it holds in itself, if its inwardness is fully understood, a key to the liberation of mankind. In the world to-day, two tendencies are at work. On the one hand, there is a need for more efficient organization, for standardization, for finding a place for everything and keeping it there. The world is, at present, a huge old curiosities' shop. It is cumbered with ideas and institutions which, once good and useful, have had their day. Its troubles are due to the fact that the persons in power cannot, or will not, see that changes have taken place. It is not possible to make re-adjustments or to rationalize the world's affairs because its rulers are looking backward, and, on account of their inherited modes of thought, are breathing out fire and fury, when the world needs commonsense and scientific management. In national and international affairs alike, there is an imperative necessity for facing the facts; and these demand that a new order should be established, with its own standards of thought and action. There was never a time, when it could be said with greater truth that things are in the saddle and rule mankind. That is why, as Mr. Zimmern says in another essay in the same book, oil and a variety of other commodities have become the staple of post-war diplomacy. There is no way out of this *mêlée*, unless man gets into the saddle and rules things, i.e. imposes his own authority over them by adopting well-considered and concerted measures of control. There is, to repeat, a need for greater organization. It simply will not do to emotionalize matters of public interest. That way lies red ruin, chaos worse than death; and the world is trying to avert it by introducing science in trade and commerce, in business and industry, in politics and sociology. Science, of course, means the scientific spirit, which knows no idols—neither of the market place nor of the cave.

This is, however, but one of the two tendencies. The other is that life is transcending itself. It is almost running riot. Man is out to defy Power, which seems omnipotent,

because he hopes to create out of the world's wreck the thing he contemplates. Pathological symptoms of this affection are events like General Lüdendorff's apostolic fervour for Paganism in Germany and the nude parades of the Sons of Freedom in Canada. There are, however, other events taking place, which show that the old-world bonds are being broken, and life is becoming a real adventure. There is an insistent demand for finding outlets for man's creative instincts in all spheres of life; and there is a revolt in the hearts and actions of men against all taboos and repressions. There is an aspiration after unconditioned freedom, a reaction against the rule of law, based on authority, in all those vital matters on which the growth of personality depends. Man wants to be his own Pole Star, and refuses to be drilled by custom, the Church and the State. The world, in these matters, needs less organization. It cannot dispense with it altogether; but man cannot fulfil himself, unless he is left to himself.

These two tendencies are working side by side; and, paradoxical as it may appear, both have a common origin and a common goal. Karl Marx expounded his philosophy of history, and showed the predominant influence of economic factors. His economic determinism is generally taken as a repudiation of the world of spirit; and the zeal with which his followers are suppressing all religious organizations, and carrying on their anti-God campaigns, appears to confirm the view that Marxism is a negation of the best in man. If Marx and his disciples are taken at their own valuation, this is a correct view of their creed and conduct. But all of us are victims of our own phrases; and the Marxists, like all other evangelists, have been caught in a web of their own creation. Yet the essence of what they believe in, and are trying to achieve, is that life cannot get a fair chance to realize its possibilities, unless we escape from what Engels called 'the realm of necessity to the realm of freedom'. The realm of necessity is the ill-organized economic life, in which man is at the mercy of elemental forces in human nature and what land and the un-co-ordinated efforts of man can give. The realm of freedom is the same life, brought

under social control and organized and mechanized in such a way as to provide a competence for all, in order that men and women may live their own lives in an atmosphere favourable for their inner development. This view of life may be called materialistic; but it is based on a faith in the destiny, or, what the pious people would call, the divinity of man. The realm of freedom is a world in which evolution would become creative—a word, by the way, of which Trotsky is as fond as Bertrand Russell—and man be really the master of his own circumstances. The two tendencies, referred to in the preceding paragraph, are mutually complementary. Politics, using the word in its widest sense, are for man, and not man for politics. Trade, industry, population, currency, the distribution of wealth and its use both for production and consumption, have to be regulated by the State and other social agencies in order to eliminate waste and inefficiency and accumulate wealth in a manner which may involve not the decay but the progress of man. Life has to be free; but the nightmare of hunger and poverty must first be banished.

This is again metaphysics or, at least, social philosophy. What has it to do with the problem of financial re-adjustment in India? This; that we have to realize the simple fact that finance is for man and not man for finance. Provincial autonomy and the separation of finances are not ends in themselves, but means to an end. Financial re-adjustments are necessary; but the right way to make them is to relate the phrases which we use to the facts of life. Finance is not, it is well worth repeating, political arithmetic, but the science of national economy. We cannot make our financial re-adjustments answer the vital needs of our national life without understanding the nature and trend of the tendencies which are re-shaping both our own country and the whole world. Nations and their institutions are in the crucible. We have to realize a creative unity, based on a wealth of differences. In the sphere of politics we express the same idea in the phrase 'integral federalism' and as politics and finance must be correlated, 'integral federalism' must also be the basis of our financial settlement. The Government

of India and the Provincial Governments must also be re-shaped, and their financial inter-relations placed on a different basis. If we once realize the utter futility of administrative and financial segregation, we shall appreciate the necessity and importance of introducing arrangements designed to harmonize the ends of autonomy and co-ordination. Mr. Zimmern, in the book referred to before, explains the success of the British in establishing their domination in India by drawing out a distinction between the urgent and the underlying facts, and attributing their success to their disregard of the underlying facts and their concentration upon the urgent ones. It will be admitted that this is a correct interpretation of the course of historical events, which has led to our political subjection. But we cannot afford to disregard the underlying facts in our struggle for political freedom, essential as it is to pay due heed also to the urgent facts. Clearly we must adopt measures which will be suited to the existing situation, if we wish those measures to be effective. But we have to establish not only good government but also self-government. Their disregard of the underlying facts has been good for the British; but it has paralysed our national life. We must not emulate their example, if we want to make good. All that has been said about the metaphysics of federal finance is intended to bring home the necessity of bearing in mind both the underlying and the urgent facts in making our financial re-adjustments. We started with the metaphysics of the differences which do not divide, and we have finished with the metaphysics of the measures of control which will lead to unconditioned freedom; and both in a book, which has been written with the specific object of making a practical contribution to the problem of impending financial re-adjustments in India. The discerning reader will, it is hoped, see the connexion between the scheme of federal finance, suggested in this book, and its metaphysics. The ultimate and the immediate are one. That they are different is an illusion; and it is necessary to conquer this illusion if the new freedom is to endure and enrich our national life.

## TABLE I

Statement showing expenditure in the different Provinces on certain services in 1857–58.

*(Figures taken from Dr. P. N. Banerjea's 'Indian Finance in the Days of the Company')*

| Provinces | Civil Expenditure | Judicial and Police | Education (1856–57) | Medical |
|---|---|---|---|---|
| | £ | £ | £ | £ |
| Bombay ... ... ... | 380,760 | 708,250 | 35,273 | 23,170 |
| Madras ... ... ... | 447,347 | 440,324 | 34,222 | 18,311 |
| Punjab ... ... ... | 221,567 | 457,370 | 14,487 | 7,191 |
| North-West Provinces (Now U.P.) ... | 1,120,795 | 315,628 | 33,000 | 39,902 |
| Bengal ... ... ... | 423,079 | 708,250 | 94,822 | 40,315 |

## TABLE II

Statement showing the Provincial Assignments in 1871–72, per 1,000 of population.

| Provinces | Rs. |
|---|---|
| Bombay ... ... ... ... | 539·92 |
| Central Provinces ... ... ... ... | 307·54 |
| Madras ... ... ... ... | 244·04 |
| Punjab ... ... ... ... | 293·15 |
| United Provinces ... ... ... ... | 204·04 |
| Bengal ... ... — ... | 193·04 |
| Burma ... ... ... ... | 1001·25 |

## TABLE III

Statement showing expenditure in the different Provinces on certain selected services in 1876–77, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 410·18 | 101·75 | 325·56 | 252·56 | 130·06 | 80·25 |
| Central Provinces ... | 209·90 | 50·57 | 139·55 | 193·36 | 79·03 | 49·67 |
| Madras ... ... | 202·49 | 43·03 | 168·59 | 176·87 | 45·85 | 59·36 |
| Punjab ... ... | 144·23 | 66·38 | 172·80 | 149·22 | 58·97 | 38·94 |
| United Provinces ... | 168·51 | 38·09 | 123·32 | 144·58 | 44·92 | 22·06 |
| Bengal ... ... | 48·28 | 27·32 | 140·06 | 69·98 | 40·77 | 28·67 |
| Assam ... ... | 198·06 | 43·63 | 152·48 | 147·87 | 47·51 | 23·27 |
| Burma ... ... | 397·00 | 127·00 | 595·00 | 457·00 | 118·50 | 73·60 |

## TABLE IV

Statement showing expenditure in the different Provinces on certain selected services in 1877–78, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 423·37 | 113·75 | 351·56 | 274·56 | 131·31 | 84·00 |
| Central Provinces ... | 209·71 | 60·28 | 134·00 | 199·13 | 77·11 | 38·93 |
| Madras ... ... | 208 72 | 41·24 | 159·15 | 120·06 | 45·43 | 44·18 |
| Punjab ... ... | 145·48 | 64·74 | 178·02 | 150·14 | 60·36 | 37·81 |
| United Provinces ... | 166·55 | 35·23 | 139·65 | 141·58 | 42·02 | 22·54 |
| Bengal ... ... | 49·78 | 27·07 | 138·64 | 73·67 | 42·61 | 28·67 |
| Assam ... ... | 201·21 | 43·87 | 151·75 | 152·00 | 46·00 | 24·24 |
| Burma ... ... | 383·00 | 130·00 | 458·00 | 610·00 | 113·40 | 84·40 |

TABLE V

Statement showing expenditure in the different Provinces on certain selected services in 1881-82, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 368·00 | 96·76 | 302·29 | 243·62 | 134·05 | 78·82 |
| Central Provinces ... | 166·08 | 51·52 | 123·84 | 165·60 | 68·80 | 36·72 |
| Madras .. ... | 231·24 | 43·67 | 152·30 | 131·25 | 54·44 | 46·93 |
| Punjab ... ... | 124·40 | 64·37 | 171·40 | 148·90 | 57·80 | 39·15 |
| United Provinces ... | 149·06 | 33·80 | 118·00 | 135·80 | 36·95 | 21·49 |
| Bengal ... ... | 47·32 | 27·28 | 136·00 | 61·00 | 41·73 | 21·67 |
| Assam ... ... | 172·99 | 44·94 | 121·64 | 183·50 | 46·59 | 23·92 |
| Burma ... ... | 515·00 | 112·50 | 410·00 | 505·00 | 86·00 | 59·50 |

## TABLE VI

Statement showing the total revenue and expenditure of the different Provinces in 1882–83 and 1886–87, per 1,000 of population.

| Provinces | 1882–83 (Initial Assignments) | | 1886–87 (Actual) | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 2,012·31 | 2,023·00 | 2,358·64 | 2,419·00 |
| Central Provinces ... | 680·91 | 654·38 | 697·34 | 814·38 |
| Madras ... ... | 705·00 | 696·00 | 804·26 | 805·00 |
| Punjab ... .. | 769·53 | 752·78 | 825·83 | 832·16 |
| United Provinces ... | 701·92 | 690·15 | 771·93 | 735·35 |
| Bengal ... ... | 588·00 | 674·00 | 660·00 | 619·00 |
| Assam ... ... | 920·00 | 896·00 | 925·00 | 884·00 |
| Burma ... ... | 3,020·00 | 3,050·00 | 1,120·00 | 1,656·00 |

## TABLE VII

Statement showing expenditure in the different Provinces on certain selected services in 1882–83, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 383·88 | 99·70 | 298·27 | 265·23 | 147·41 | 78·82 |
| Central Provinces ... | 156·08 | 51·28 | 120·72 | 173·60 | 69·68 | 34·72 |
| Madras ... ... | 236·48 | 45·46 | 151·28 | 126·61 | 73·49 | 18·81 |
| Punjab ... ... | 125·40 | 66·20 | 169·20 | 148·80 | 58·40 | 40·12 |
| United Provinces ... | 155·50 | 33·85 | 118·00 | 135·50 | 38·15 | 24·15 |
| Bengal ... ... | 50·01 | 28·31 | 138·44 | 66·58 | 45·01 | 20·61 |
| Assam ... ... | 189·69 | 47·00 | 127·83 | 168·66 | 51·54 | 24·74 |
| Burma ... ... | 575·00 | 119·50 | 418·00 | 592·00 | 87·20 | 50·00 |

TABLE VIII

Statement showing expenditure in the different Provinces on certain selected services in 1886–87, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 396·11 | 103·47 | 294·82 | 305·17 | 173·00 | 84·76 |
| Central Provinces ... | 224·24 | 56·72 | 128·96 | 175·12 | 79·85 | 35·20 |
| Madras ... ... | 251·23 | 45·30 | 156·24 | 127·73 | 64·87 | 53·46 |
| Punjab ... ... | 176·20 | 66·80 | 186·80 | 175·70 | 73·40 | 43·70 |
| United Provinces ... | 178·40 | 36·59 | 117·50 | 141·59 | 39·54 | 25·00 |
| Bengal ... ... | 52·55 | 29·92 | 143·56 | 71·19 | 50·38 | 21·81 |
| Assam ... ... | 195·87 | 47·42 | 127·21 | 195·87 | 65·97 | 36·90 |
| Burma ... ... | 654·32 | 210·27 | 627·83 | 1,760·00 | 133·78 | 81·35 |

## TABLE IX.

Statement showing the total revenue and expenditure of the different Provinces in 1887–88 and 1891–92, per 1,000 of population.

| Provinces | 1887–88 (Initial Assignments) | | 1891–92 (Actual) | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 2,300·31 | 2,300·31 | 2 518·19 | 2,489·88 |
| Central Provinces ... | 711·12 | 711·12 | 835·51 | 828·46 |
| Madras ... ... | 826·96 | 826·96 | 928·06 | 922·77 |
| Punjab ... ... | 833·31 | 831·68 | 921·05 | 943·89 |
| United Provinces ... | 736·38 | 730·02 | 762·81 | 702·97 |
| Bengal ... ... | 562·44 | 562·44 | 862·71 | 849·59 |
| Assam ... ... | 946·93 | 946·93 | 1,181·42 | 1,142·65 |
| Burma ... ... | 1,270·90 | 1,270·90 | 2,162·20 | 2,158·96 |

## TABLE X

Statement showing expenditure in the different Provinces on certain selected services in 1887–88, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 387·41 | 104·58 | 317·11 | 288·76 | 169·41 | 86·17 |
| Central Provinces ... | 233·04 | 57·04 | 126·84 | 171·04 | 79·68 | 36·48 |
| Madras ... ... | 254·46 | 46·60 | 157·92 | 123·63 | 62·23 | 53·23 |
| Punjab ... ... | 179·80 | 65·20 | 193·20 | 178·15 | 62·50 | 41·80 |
| United Provinces ... | 178·40 | 35·63 | 120·00 | 142·68 | 39·31 | 23·86 |
| Bengal .. ... | 50·83 | 29·76 | 144·34 | 72·11 | 52·55 | 21·68 |
| Assam ... ... | 192·98 | 51·34 | 125·77 | 197·93 | 65·97 | 37·11 |
| Burma ... ... | 747·83 | 258·91 | 429·45 | 2,807·83 | 122·43 | 115·13 |

## TABLE XI

Statement showing expenditure in the different Provinces on certain selected services in 1891–92, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 351·00 | 94·50 | 265·00 | 290·00 | 168·00 | 78·60 |
| Central Provinces ... | 220·58 | 51·69 | 83·17 | 158·70 | 72·49 | 32·88 |
| Madras ... ... | 253·00 | 43·50 | 148·00 | 116·60 | 69·50 | 68·50 |
| Punjab ... | 202·00 | 66·00 | 205·00 | 191·00 | 71·80 | 62·90 |
| United Provinces ... | 162·32 | 32·58 | 131·58 | 139·42 | 40·60 | 24·59 |
| Bengal ... ... | 57·65 | 30·60 | 147·23 | 84·65 | 51·33 | 23·04 |
| Assam ... ... | 172·40 | 44·20 | 100·00 | 227·00 | 61·70 | 47·30 |
| Burma ... ... | 528·00 | 134·00 | 415·00 | 1,247·00 | 68·00 | 51·80 |

## TABLE XII

Statement showing the total revenue and expenditure of the different Provinces in 1892–93 and 1896–97, per 1,000 of population.

| Provinces | 1892–93 | | 1896–97 | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 2,060·89 | 2,060·89 | 2,135 | 2,096 |
| Central Provinces ... | 729·72 | 729·72 | 719 | 706 |
| Madras ... ... | 787·83 | 787·83 | 897 | 890 |
| Punjab ... ... | 904·68 | 904·68 | 938 | 969 |
| United Provinces ... | 672·26 | 672·26 | 703 | 648 |
| Bengal ... ... | 575·38 | 575·38 | 654 | 632 |
| Assam ... ... | 990·09 | 990·09 | 1,188 | 1,149 |
| Burma ... ... | 2,391·94 | 2,391·94 | 2,758 | 2,770 |

## TABLE XIII

Statement showing expenditure in the different Provinces on certain selected services in 1892–93, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 359·00 | 96·00 | 264·00 | 278·00 | 168·00 | 84·50 |
| Central Provinces ... | 231·19 | 59·94 | 95·54 | 169·65 | 70·89 | 36·63 |
| Madras ... ... | 259·16 | 43·55 | 154·53 | 118·23 | 73·10 | 69·74 |
| Punjab ... ... | 195·60 | 69·00 | 208·00 | 201·50 | 72·20 | 66·50 |
| United Provinces ... | 158·67 | 33·64 | 130·74 | 122·13 | 42·21 | 26·50 |
| Bengal ... ... | 64·02 | 31·21 | 149·05 | 85·70 | 50·37 | 23·93 |
| Assam ... ... | 170·00 | 54·60 | 99·20 | 212·50 | 62·00 | 50·50 |
| Burma ... .. | 570·00 | 142·00 | 418·00 | 1,198·00 | 71·50 | 56·70 |

## TABLE XIV

Statement showing expenditure in the different Provinces on certain selected services in 1896–97, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 355·50 | 105·00 | 276·50 | 325·00 | 183·40 | 99·20 |
| Central Provinces ... | 232·25 | 70·22 | 101·78 | 184·97 | 76·71 | 41·23 |
| Madras ... ... | 274·00 | 46·10 | 158·41 | 130·19 | 78·68 | 77·89 |
| Punjab ... ... | 208·40 | 72·20 | 232·00 | 216·00 | 72·40 | 105·00 |
| United Provinces ... | 167·37 | 35·79 | 157·80 | 155·69 | 46·80 | 28·39 |
| Bengal ... ... | 73·06 | 33·56 | 161·60 | 92·08 | 55·23 | 36·17 |
| Assam ... ... | 178·40 | 66·00 | 107·30 | 266·00 | 73·60 | 61·40 |
| Burma ... ... | 560·00 | 160·50 | 497·00 | 1,167·00 | 93·80 | 69·50 |

## TABLE XV

Statement showing the total revenue and expenditure of the different Provinces in 1897–98 and 1906–07, per 1,000 of population.

| Provinces | 1897–98 | | 1906–07 | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 2,271·06 | 2,241·80 | 3,005·52 | 2,913·05 |
| Central Provinces ... | 831·94 | 818·98 | 1,729·91 | 1,583·83 |
| Madras ... ... | 888·12 | 888·20 | 1,277·82 | 1,245·96 |
| Punjab ... ... | 991·78 | 1,029·36 | 1,620·25 | 1,653·57 |
| United Provinces ... | 751·00 | 705·70 | 1,027·12 | 1,010·19 |
| Bengal ... ... | 653·14 | 627·32 | ... | ... |
| Assam ... ... | 1,302·18 | 125·00 | ... | ... |
| Burma ... ... | 4,075·71 | 4,103·50 | 4,451·14 | 4,271·04 |

# TABLE XVI

Statement showing expenditure in the different Provinces on certain selected services in 1897–98, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 362·00 | 106·40 | 279·00 | 346·00 | 178·00 | 204·00 |
| Central Provinces ... | 246·30 | 72·27 | 108·60 | 183·70 | 77·99 | 45·80 |
| Madras ... ... | 281·62 | 45·15 | 161·96 | 130·59 | 79·63 | 78·87 |
| Punjab ... ... | 210·00 | 71·60 | 236·00 | 210·00 | 73·30 | 112·80 |
| United Provinces ... | 169·06 | 36·24 | 161·89 | 160·34 | 47·39 | 32·76 |
| Bengal ... ... | 69·19 | 32·05 | 162·98 | 95·19 | 55·19 | 37·29 |
| Assam ... ... | 179·20 | 63·80 | 112·40 | 263·90 | 75·00 | 66·90 |
| Burma ... ... | 595·00 | 160·00 | 450·00 | 1,178·00 | 102·00 | 68·30 |

## TABLE XVII

Statement showing expenditure in the different Provinces on certain selected services in 1906–07, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 404·00 | 113·00 | 322·40 | 372·00 | 251·00 | 134·30 |
| Central Provinces .. | 285·80 | 83·93 | 173·07 | 255·47 | 140·34 | 62·73 |
| Madras ... ... | 298·90 | 44·79 | 163·53 | 152·27 | 105·99 | 90·23 |
| Punjab ... ... | 232·11 | 51·23 | 241·82 | 229·40 | 110·04 | 58·52 |
| United Provinces ... | 179·12 | 43·37 | 121·04 | 213·81 | 90·71 | 39·09 |
| Bengal† ... ... | 71·10 | 34·20 | 168·00 | 98·00 | 73·70 | 37·00 |
| Assam† ... ... | 178·00 | 58·60 | 120·80 | 255·00 | 112·20 | 78·00 |
| Burma ... ... | 596·00 | 146·70 | 436·00 | 960·00 | 182·40 | 195·00 |

† These are figures of expenditure in 1904–05 and not of 1906–07.

## TABLE XVIII

Statement showing the distribution of Grants-in-aid to the different Provinces by the Government of India from 1897–98 to 1906–07, 1907–08 to 1911–12 and 1912–13 to 1918–19, per 10,000 of population.

| Provinces | 1897–98 to 1906–07 | 1907–08 to 1911–12 | 1912–13 to 1918–19 |
|---|---|---|---|
| | Rs. | Rs. | Rs. |
| Bombay ... ... | 2,542·10 | 1,738·94 | 1,221·00 |
| Central Provinces ... | 1,750·00 | 1,250·00 | 1,928·57 |
| Madras ... ... | 647·70 | 510·47 | 830·91 |
| Punjab ... ... | 1,020·40 | 1,536·22 | 1,790·00 |
| United Provinces ... | 340·42 | 595·74 | 651·06 |
| Bengal ... ... | 233·33 | 442·85 | 1,323·07 |
| Assam ... ... | 1,305·08 | 2,881·35 | 4,411·76 |
| Burma ... ... | 990·47 | 1,009·52 | 1,750·00 |
| Bihar and Orissa ... | ... | ... | 653·85 |

## TABLE XIX

Statement showing the total revenue and expenditure of the different Provinces in 1907–08 and 1911–12, per 1,000 of population.

| Provinces | 1907-08 | | 1911-12 | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 3,034·63 | 3,054·00 | 3,540·35 | 3,811·05 |
| Central Provinces ... | 1,791·52 | 1,868·75 | 1,933·07 | 1,846·28 |
| Madras ... ... | 1,299·08 | 1,300·26 | 1,952·60 | 1,623·04 |
| Punjab ... ... | 1,582·95 | 1,705·81 | 2,187·60 | 2,017·70 |
| United Provinces ... | 1,003·44 | 1,079·76 | 1,282·95 | 1,279·87 |
| Bengal ... ... | ... | ... | ... | ... |
| Assam ... ... | ... | ... | ... | ... |
| Burma ... ... | 4,196·76 | 4,494·85 | 4,302·00 | 4,407·00 |

## TABLE XX

Statement showing expenditure in the different Provinces on certain selected services in 1907–08, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 411·00 | 117·50 | 326·00 | 421·00 | 261·00 | 121·00 |
| Central Provinces ... | 303·65 | 87·50 | 184·95 | 280·25 | 146·15 | 65·89 |
| Madras ... ... | 310·65 | 45·75 | 170·89 | 168·82 | 121·09 | 46·50 |
| Punjab ... ... | 236·99 | 52·06 | 234·28 | 257·83 | 111·72 | 58·42 |
| United Provinces ... | 178·20 | 45·43 | 120·41 | 223·75 | 91·56 | 46·14 |
| Bengal ... ... | 71·10 | 34·20 | 168·00 | 98·40 | 73·70 | 37·00 |
| Assam ... ... | 178·00 | 58·60 | 120·80 | 255·00 | 112·20 | 78·00 |
| Burma ... ... | 614·00 | 160·00 | 510·00 | 970·00 | 194·00 | 212·50 |

## TABLE XXI

Statement showing expenditure in the different Provinces on certain selected services in 1911–12, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 426·40 | 177·40 | 344·00 | 522·00 | 251·30 | 124·20 |
| Central Provinces ... | 278·00 | 85·49 | 219·78 | 238·97 | 127·32 | 70·07 |
| Madras ... ... | 308·78 | 53·79 | 182·00 | 201·88 | 108·90 | 43·60 |
| Punjab ... ... | 246·30 | 70·00 | 279·23 | 300·66 | 121·70 | 109·07 |
| United Provinces ... | 180·00 | 49·98 | 129·75 | 230·06 | 100·75 | 62·50 |
| Bengal ... ... | 71·10 | 34·20 | 168·00 | 98·40 | 73·70 | 27·00 |
| Assam ... ... | 178·00 | 58·60 | 120·80 | 255·00 | 112·20 | 78·00 |
| Burma ... ... | 560·00 | 203·00 | 502·00 | 1,040·00 | 166·00 | 179·00 |

## TABLE XXII

Statement showing the total revenue and expenditure of the different Provinces in 1912–13 and 1920–21, per 1,000 of population.

| Provinces | 1912–13 | | 1920–21 | |
|---|---|---|---|---|
| | Revenue | Expenditure | Revenue | Expenditure |
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 3,979·05 | 3,624·90 | 6,178·7 | 6,672·05 |
| Central Provinces ... | 2,324·14 | 1,960·92 | 2,749·42 | 2,947·57 |
| Madras ... ... | 1,829·54 | 1,848·01 | 2,397·24 | 2,872·97 |
| Punjab ... ... | 2,547·75 | 2,177·20 | 3,321·75 | 3,672·70 |
| United Provinces ... | 1,506·14 | 1,302·12 | 1,806·08 | 2,088·10 |
| Bengal ... ... | 1,592·28 | 1,265·51 | 1,866·08 | 2,007·53 |
| Assam ... ... | 2,618·67 | 2,087·79 | 2,734·92 | 2,906·56 |
| Burma ... ... | 5,069·33 | 4,329·83 | 6,979·83 | 7,066·41 |
| Bihar and Orissa... ... | 971·50 | 767·97 | 910·14 | 1,244·17 |

## TABLE XXIII

Statement showing expenditure in the different Provinces on certain selected services in 1912–13, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 434·12 | 129·74 | 354·12 | 527·48 | 316·23 | 121·13 |
| Central Provinces ... | 239·87 | 65·93 | 160·06 | 208·19 | 132·31 | 66·93 |
| Madras ... ... | 339·11 | 43·77 | 192·14 | 210·42 | 156·39 | 48·97 |
| Punjab ... ... | 255·07 | 63·84 | 293·94 | 300·21 | 176·76 | 132·56 |
| United Provinces ... | 182·20 | 48·22 | 128·35 | 226·77 | 117·00 | 61·80 |
| Bengal ... ... | 108·00 | 64·00 | 248·00 | 178·00 | 157·00 | 56·00 |
| Assam ... ... | 198·80 | 107·70 | 166·40 | 315·80 | 139·00 | 88·70 |
| Burma ... ... | 573·00 | 121·00 | 522·00 | 1,060·00 | 192·00 | 180·00 |
| Bihar and Orissa ... | 96·90 | 42·80 | 126·58 | 121·51 | 80·82 | 21·66 |

## TABLE XXIV

Statement showing expenditure in the different Provinces on certain selected services in 1920–21, per 1,000 of population.

| Provinces | District Administration | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 1,172·60 | 188·11 | 533·62 | 890·96 | 736·02 | 293·57 |
| Central Provinces ... | 518·25 | 110·42 | 288·50 | 403·71 | 357·14 | 115·57 |
| Madras ... ... | 446·85 | 57·97 | 354·25 | 427·46 | 321·23 | 163·98 |
| Punjab ... ... | 514·10 | 135·00 | 303·50 | 480·90 | 351·75 | 159·00 |
| United Provinces ... | 356·83 | 65·91 | 212·75 | 376·83 | 334·20 | 106·76 |
| Bengal ... ... | 229·31 | 91·11 | 304·54 | 367·71 | 239·08 | 112·44 |
| Assam ... ... | 274·77 | 114·17 | 162·23 | 393·00 | 280·29 | 167·01 |
| Burma ... ... | 1,155·30 | 181·80 | 433·38 | 1,505·37 | 382·80 | 283·80 |
| Bihar and Orissa ... | 167·44 | 58·77 | 150·23 | 202·38 | 157·29 | 57·41 |

## TABLE XXV

Statements showing total revenue and expenditure in 1921–22 and 1928–29, per 1,000 of population, and percentage of growth of revenue in the different Provinces.

In 1921–22

| Provinces | Total revenue (in lacs) | Revenue per 1,000 | Total expenditure (in lacs) | Expenditure per 1,000 |
|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... ... | 13,11 | 6,756·34 | 1[illegible],02 | 7,726·44 |
| Central Provinces ... ... | 4,72 | 3,394·82 | 4,95 | 3,564·02 |
| Madras ... ... ... | 11,75 | 2,777·51 | 12,74 | 3,010·89 |
| Punjab ... ... ... | 7,10 | 3,428·45 | 8,81 | 4,256·61 |
| United Provinces ... ... | 10,02 | 2,206·05 | 11,49 | 2,531·76 |
| Bengal ... ... ... | 8,32 | 1,782·53 | 10,48 | 2,243·91 |
| Assam ... ... ... | 1,82 | 2,388·55 | 2,05 | 2,700·39 |
| Burma ... ... ... | 9,18 | 6,952·34 | 9,04 | 6,846·06 |
| Bihar and Orissa ... ... | 4,43 | 1,301·82 | 4,58 | 1,346·97 |

TABLE XXV—(*continued*)

In 1928–29

| Provinces | Total revenue (in lacs) | Revenue per 1,000 | Total expenditure (in lacs) | Expenditure per 1,000 | Percentage increase of revenue between 1921–22 and 1928–29 |
|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | |
| Bombay ... ... | 15,74 | 8,284·21 | 16,13 | 8,489·47 | 17·37 |
| Central Provinces ... | 5,54 | 4,261·53 | 5,68 | 4,369·23 | 11·91 |
| Madras ... ... | 16,97 | 4,040·47 | 16,99 | 4,045·23 | 10·12 |
| Punjab ... ... | 12,73 | 6,365·00 | 12,77 | 6,385·00 | 41·75 |
| United Provinces ... | 12,47 | 2,771·11 | 11,92 | 2,648·88 | 25·40 |
| Bengal ... ... | 10,93 | 2,376·08 | 11,24 | 2,443·47 | 22·23 |
| Assam ... ... | 2,78 | 3,971·42 | 2,82 | 4,028·57 | 41·11 |
| Burma ... ... | 10,73 | 8,253·84 | 11,78 | 9,061·53 | 19·22 |
| Bihar and Orissa ... | 5,74 | 1,688·23 | 5,88 | 1,729·40 | 29·57 |

## TABLE XXVI

Statement showing expenditure in the different Provinces on certain selected services in 1921–22, per 1,000 of population.

| Provinces | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 635·33 | 530·46 | 994·81 | 893·52 | 389·37 |
| Central Provinces .. | 347·05 | 296·04 | 408·77 | 336·69 | 124·65 |
| Madras ... ... | 319·38 | 293·45 | 473·75 | 338·86 | 225·20 |
| Punjab ... ... | 423·93 | 389·32 | 560·04 | 429·12 | 206·45 |
| United Provinces ... | 303·97 | 228·07 | 401·32 | 335·54 | 114·63 |
| Bengal ... ... | 241·15 | 305·38 | 413·32 | 258·88 | 163·19 |
| Assam ... ... | 335·00 | 159·03 | 302·63 | 310·13 | 217·63 |
| Burma ... ... | 638·86 | 402·41 | 1,120·37 | 444·46 | 292·12 |
| Bihar and Orissa ... | 203·50 | 147·02 | 239·14 | 159·88 | 60·76 |

## TABLE XXVII

Statement showing expenditure in the different Provinces on certain selected services in 1927–28, per 1,000 of population.

| Provinces | General Administration | Law and Justice | Police | Education | Medical |
|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bombay ... ... | 1,152 | 506 | 863 | 1,050 | 367 |
| Central Provinces ... ... | 474 | 302 | 424 | 402 | 137 |
| Madras ... ... | 539 | 303 | 442 | 510 | 253 |
| Punjab ... ... | 531 | 439 | 527 | 753 | 327 |
| United Provinces ... ... | 287 | 234 | 341 | 377 | 132 |
| Bengal ... ... | 280 | 319 | 413 | 307 | 201 |
| Assam ... ... | 381 | 184 | 316 | 368 | 316 |
| Burma ... ... | 817 | 742 | 1,135 | 848 | 515 |
| Bihar and Orissa ... ... | 211 | 170 | 244 | 255 | 132 |

(District Administration omitted on account of the change of classification.)

## TABLE XXVIII

Statement showing revenue and expenditure of Bengal under Principal Heads in 921–22 and 1927–28.

| Principal Heads | Revenue 1921–22 | Revenue 1927–28 | Principal Heads | Expenditure 1921–22 | Expenditure 1927–28 |
|---|---|---|---|---|---|
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 3,02 | 3,15 | General Administration ... | 1,13 | 1,26 |
| Excise ... ... | 1,83 | 2,30 | Law and Justice ... | 1,43 | 1,45 |
| Stamps ... ... | 2,74 | 3,47 | Police ... ... | 2,00 | 2,00 |
| Forests ... ... | 18 | 32 | Education ... ... | 1,21 | 1,43 |
| Registration ... ... | 25 | 30 | Medical ... ... | 76 | 94 |
| Scheduled Taxes ... ... | ... | 20 | Other Beneficent Departments ... ... | 33 | 38 |
| Irrigation ... ... | 21 | –4 | | | |

# TABLE XXIX

Statement showing revenue and expenditure of the United Provinces under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921-22 | 1927-28 | | 1921-22 | 1927-28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 6,81 | 6,92 | General Administration ... | 1,38 | 1,31 |
| Excise ... ... ... | 1,49 | 1,39 | Law and Order ... ... | 1,04 | 1,07 |
| Stamps ... ... ... | 1,51 | 1,82 | Police ... ... ... | 1,82 | 1,63 |
| Forests ... ... ... | 86 | 59 | Education ... ... | 1,52 | 1,71 |
| Registration ... ... | 13 | 14 | Medical ... ... | 52 | 59 |
| Irrigation ... ... | 93 | 1,01 | Other Beneficent Departments ... ... | 37 | 43 |

TABLE XXX

Statement showing revenue and expenditure of Madras under Principal Heads in 921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921–22 | 1927–28 | | 1921–22 | 1927–28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 6,08 | 7,55 | General Administration ... | 1,35 | 2,28 |
| Excise ... ... ... | 4,89 | 4,95 | Law and Justice ... | 1,25 | 1,29 |
| Stamps ... ... | 1,90 | 2,45 | Police ... ... | 2,00 | 1,87 |
| Forests ... ... | 49 | 51 | Education ... ... | 1,44 | 2,16 |
| Registration .. ... | 33 | 39 | Medical ... ... | 95 | 1,07 |
| Irrigation ... ... | 91 | 36 | Other Beneficent Departments ... ... | 53 | 53 |

TABLE XXXI

Statement showing revenue and expenditure of Bihar and Orissa under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921–22 | 1927–28 | | 1921–22 | 1927–28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 1,65 | 1,66 | General Adminsitration ... | 70 | 72 |
| Excise ... ... | 1,24 | 1,98 | Law and Justice ... ... | 50 | 58 |
| Stamps ... ... | 88 | 1,08 | Police ... ... | 82 | 83 |
| Forests ... ... | 9 | 10 | Education ... ... | 55 | 86 |
| Registration ... ... | 9 | 15 | Medical ... ... | 21 | 46 |
| Irrigation ... ... | 17 | 19 | Other Beneficent Departments ... ... | 12 | 24 |

## TABLE XXXII

Statement showing revenue and expenditure of the Punjab under Principal Heads in 921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921–22 | 1927–28 | | 1921–22 | 1927–28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 2,46 | 2,85 | General Administration ... | 97 | 1,09 |
| Excise ... ... ... | 1,16 | 1,09 | Law and Justice ... ... | 80 | 90 |
| Stamps ... ... | 82 | 1,05 | Police ... ... .. | 1,15 | 1,08 |
| Forests ... ... ... | 50 | 41 | Education ... ... | 88 | 155 |
| Registration ... ... | 6 | 9 | Medical ... ... | 43 | 68 |
| Irrigation ... ... | 4,85 | 4,67 | Other Beneficent Departments ... ... | 38 | 63 |

## TABLE XXXIII

Statement showing revenue and expenditure of Bombay under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921–22 | 1927–28 | | 1921–22 | 1927–28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 5,48 | 5,30 | General Administration ... | 1,22 | 2,23 |
| Excise ... ... ... | 3,43 | 4,00 | Law and Justice ... ... | 1,02 | 99 |
| Stamps ... ... ... | 1,65 | 1,87 | Police ... ... ... | 1,92 | 1,69 |
| Forests ... ... ... | 74 | 74 | Education ... ... | 1,72 | 2,05 |
| Registration ... ... | 13 | 13 | Medical... ... ... | 75 | 71 |
| Irrigation ... ... | 34 | 25 | Other Beneficent Departments ... ... | 11 | 38 |
| Scheduled Taxes ... ... | ... | 23 | | | |

TABLE XXXIV

Statement showing revenue and expenditure of Central Provinces under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921–22 | 1927–28 | | 1921–22 | 1927–28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 2,65 | 2,50 | General Administration ... | 49 | 66 |
| Excise ... ... ... | 1,05 | 1,47 | Law and Justice ... ... | 41 | 42 |
| Stamps ... ... | 50 | 62 | Police ... ... ... | 56 | 59 |
| Forests ... ... | 42 | 50 | Education ... ... | 46 | 56 |
| Registration ... ... | 6 | 6 | Medical ... ... | 17 | 19 |
| Irrigation ... ... | –4 | 1 | Other Beneficent Departments ... ... | 15 | 20 |

## TABLE XXXV

Statement showing revenue and expenditure of Burma under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921-22 | 1927-28 | | 1921-22 | 1927-28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 530 | 535 | General Administration ... | 84 | 108 |
| Excise ... ... | 98 | 122 | Law and Justice ... ... | 66 | 98 |
| Stamps ... ... | 49 | 69 | Police ... ... ... | 148 | 150 |
| Forests ... ... | 221 | 187 | Education ... ... | 59 | 112 |
| Registration ... ... | 50 | ... | Medical ... ... | 38 | 68 |
| Irrigation ... ... | 79 | ... | Other Beneficent Departments ... ... | 15 | 25 |

## TABLE XXXVI

Statement showing revenue and expenditure of Assam under Principal Heads in 1921–22 and 1927–28.

| Principal Heads | Revenue | | Principal Heads | Expenditure | |
|---|---|---|---|---|---|
| | 1921-22 | 1927-28 | | 1921-22 | 1927-28 |
| | (in lacs) | | | (in lacs) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Land Revenue ... ... | 96 | 1,13 | General Administration ... | 26 | 29 |
| Excise ... ... ... | 60 | 71 | Law and Justice ... ... | 12 | 14 |
| Stamps ... ... | 15 | 23 | Police ... .. ... | 23 | 24 |
| Forests ... ... | 13 | 33 | Education ... ... | 23 | 28 |
| Registration ... ... | 1 | 2 | Medical ... ... | 16 | 24 |
| Irrigation ... ... | ... | ... | Other Beneficent Departments ... ... | 5 | 7 |

# TABLE XXXVII

Statement showing amounts realized by the Provinces under Devolution Rule 15.
(Figures in lacs)

| Provinces | 1921-22 | 1922-23 | 1923-24 | 1924-25 | 1925-26 | 1926-27 | 1927-28 Revised | 1928-29 Budget |
|---|---|---|---|---|---|---|---|---|
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Bengal ... | 0·95 | ... | ... | ... | ... | ... | ... | ... |
| United Provinces ... | 3·20 | 0·33 | ... | ... | 0·03 | ... | ... | ... |
| Madras ... | 4·08 | ... | 10·82 (5·66) | 1·57 | 4·27 | 4·64 | 5·20 | 6·50 |
| Bihar and Orissa ... | 0·58 | 2·87 | 2·55 | 2·55 | 2·41 | 3·25 | 3·60 | 3·50 |
| Punjab ... | 0·30 | 5·69 | 4·24 (0·06) | 1·90 | 3·82 | 4·02 | 3·50 | 4·00 |
| Bombay ... | 14·72 | 3·00 | ... (13·50) | .. | ... | ... | ... | ... |
| Central Provinces ... | 0·90 | 1·49 (0·39) | 3·42 | 2·30 | 1·36 | 2·18 | 1·60 | 2·00 |
| Burma ... | 3·85 | ... (1.11) | 0·38 (−0·08) | 5·90 | 8·92 | 14·32 | 15·00 | 14·00 |
| Assam ... | 0·02 | 1.15 | 4·16 | 5·54 | 5·29 | 4·92 | 6·00 | 6·00 |
| Total ... | 28·60 | 14·53 (1·50) | 25·57 (19·14) | 19·76 | 26·10 | 33·33 | 34·90 | 36·00 |

*N.B.*—Figures in brackets indicate adjustments on account of previous years.

TABLE XXXVIII

Statement showing revenue and expenditure of the Government of India under Principal Heads in 1921–22 and 1928–29.

| Principal Heads | Revenue 1921-22 | Revenue 1928–29 (B.E.) | Principal Heads | Expenditure 1921–22 | Expenditure 1928–29 (B.E.) |
|---|---|---|---|---|---|
| | (in crores) | | | (in crores) | |
| | Rs. | Rs. | | Rs. | Rs. |
| Customs ... ... | 34·41 | 51·18 | Collection of Taxes ... | 5·37 | 4·25 |
| Income-Tax ... ... | 18·74 | 16·10 | Interest ... ... | 15·99 | 14·91 |
| Salt ... ... | 6·34 | 7·00 | Civil Administration ... | 9·40 | 11·69 |
| Opium ... ... | 3·07 | 3·47 | Military Service (net expenditure) ... ... | 69·81 | 55·10 |
| Other Heads ... ... | 2·20 | 2·20 | | | |
| Railway Net Receipts ... | 9·25 | 5·49 | | | |

## TABLE XXXIX

Statement showing population and area of the Provinces according to the Census of 1921.

| Provinces | Population in lacs | Area in sq. miles |
|---|---|---|
| Bengal ... ... | 467 | 76,843 |
| United Provinces ... | 454 | 106,295 |
| Madras ... ... | 423 | 142,260 |
| Bihar and Orissa ... | 340 | 83,161 |
| Punjab ... ... | 206 | 99,846 |
| Bombay ... ... | 194 | 123,621 |
| Central Provinces ... | 140 | 99,876 |
| Burma ... ... | 132 | 233,707 |
| Assam ... ... | 76 | 53,015 |

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